

Broadcasting Policy Group

Beyond the Charter

The BBC after 2006

In 2006, the Royal Charter under which the BBC operates will expire, and new arrangements will have to replace it. The form these will take must be decided at a time of both change and controversy. As channels proliferate, the corporation's once unchallenged role in the broadcasting firmament is being transformed. At the same time, the scale of its activities, the character of its output and the way it is run and funded are being questioned as never before, while the Hutton verdict has called into question its journalism, management and governance.

During May 2003, the Conservative Party asked a group of broadcasting experts to analyse the issues raised and to propose a path through them. The group were entirely independent of the party, which is not bound to accept their conclusions. This report sets out their proposals.

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David Elstein (Chairman)

David Cox

Barbara Donoghue

David Graham

Geoff Metzger

February, 2004

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Contents

Foreword David Elstein, Chairman, Broadcasting Policy Group	3
Introduction	5
Chapter One: Public Service <i>Public service broadcasting is vitally important, but its future is threatened. Radically different ways of delivering it are required.</i>	10
Chapter Two: The Creative Economy <i>The BBC is a key part of the creative economy, but its structure and policies do not serve the best interests of the creative community. A new structure would release the creative flows in the industry and resolve long-standing complaints of anti-competitive behaviour by the BBC.</i>	26
Chapter Three: Funding the BBC <i>The television licence fee should be steadily reduced from 2007 onwards, and gradually replaced by a combination of subscription and indirect public funding. It should be abolished completely when analogue television transmission is switched off.</i>	42
Chapter Four: Governance, Regulation, Accountability <i>The era of Charters and Governors should end. In future, the BBC should be regulated by consumer power, creative and commercial competition and a new institutional structure.</i>	56
Summary and Recommendations	64
The Authors	68

Foreword

David Elstein
Chairman, Broadcasting Policy Group



I am grateful to John Whittingdale MP for suggesting the formation of the Broadcasting Policy Group to analyse the issues raised by BBC Charter review and to propose a way through them. We have spent seven months in deliberation and have found the discussions, the papers submitted and the background reading challenging and stimulating. Our conclusions are, of course, our own, and are published by us, not the Conservative Party.

I greatly appreciate the (unpaid) time and effort my colleagues have invested in this report. Two members of the Group, Peter Ibbotson and Alex Mahon, withdrew during the drafting because they disagreed with aspects of the emerging majority view. Nonetheless, their contributions were much valued by the Group. I am also grateful to Philippa Miles, who took substantial responsibility for the Group's administration.

We also owe thanks to Nolan Wolff for the business modelling which helped enormously in our analysis, to Cresta Norris for aiding publication and to Charles Stewart-Smith and Simon Buckby and their colleagues at Luther Pendragon for advising on presentation.

David Elstein
Chairman, Broadcasting Policy Group
24 February, 2004

Introduction

1. The BBC is one of our most respected institutions; loved by many, admired by even more. For as long as most of us have lived, it has been enriching our lives day by day. No other cultural force can begin to compete with the contribution it has made to the entertainment and enlightenment of our nation. In other countries, it is often a source of envy. It is also our only home-grown media operation of real global consequence. Yet today, even those most eager to see it flourish must fear for its future.
2. Even before the Hutton crisis, the Corporation had become the target of growing criticism. Competitors present it as rampaging through the broadcasting landscape, exploiting its state backing and abusing its dominant market position. At the same time, it is also suggested that its size, structure and funding mechanism may have become obstacles to the full realisation of its creative potential.
3. Even those who ought to be the BBC's staunchest allies are voicing concerns. People who look to broadcasting to educate, inform and raise the level of public discourse increasingly maintain that the BBC is letting them down. Where they expect originality, intelligence, reliability, profundity and ambition, they feel they find something less. Some object that the Corporation's powerful hold on our cultural life is squeezing out other voices, to the detriment of both creative diversity and democratic pluralism.
4. These concerns are being aired at a time when the whole broadcasting sector is in the throes of enormous change. Once the country's sole broadcaster, the Corporation is having to reposition itself among what will soon be 400 television channels, a growing array of digital radio channels, the near-infinite expanses of the internet and yet further new forms of broadcasting like third-generation mobile telephony.
5. It is against this background that the BBC's Royal Charter will expire on 31st December, 2006. The government plans to publish a White Paper on the subject by the end of 2004. In May 2003, the Conservative Party asked the former TV executive David Elstein to assemble a group of broadcasting experts to advise it on what its own policy should be. This is the report of that Broadcasting Policy Group. It expresses our views as individuals, not the positions of any organisations with which we may be associated.

6. All of us appreciated that any great public institution is bound to attract brickbats. We listened to those who argue that the BBC's currently perceived failings can be blamed simply on mismanagement. Yet we could not avoid the conclusion that some of the current complaints actually reflect fundamental weaknesses in the arrangements by which the Corporation operates. What is more, we saw reason to suppose that, left to themselves, things would get worse not better.
7. This is not so surprising. The BBC is, after all, the product of a very different age. The arrangements by which it functions survive surprisingly little changed from the 1920s. It would be strange if they happened to fit today's requirements, and even more surprising if we could rely on them to carry us successfully into what will be an even more different future.
8. Of course, no-one would want to tamper with such a successful institution without good cause. Tolerating a few imperfections in a reasonably well functioning system may often be preferable to a drastic overhaul whose outcome can never be wholly certain. Yet, we concluded that a moment has now arrived at which the likely benefits of radical change clearly outweigh the more obvious attractions of trying to soldier on.
9. Any large institution pursues its own institutional interests. In the BBC's case, those interests have come to be identified crucially with the preservation and enhancement of its unique funding mechanism - the television licence fee. To maximise popular support for this highly visible tax, the Corporation strives ever harder to sustain its share of the nation's television, radio and internet use. In the process, it feels obliged to extend its activities into fields in which commercial providers are already delivering effective services without the benefit of state support. In doing this, it potentially damages the creative economy by squeezing out other suppliers, and in the process weakens the creative community.
10. So that it can reach as many licence payers as possible, the Corporation feels compelled to ensure that its output is as popular as possible, for as much of the time as possible. This apparently reasonable aim has negative consequences. Pursuit of ratings can entail over-provision of the derivative and familiar. Programming intended to educate and inform must be designed to achieve those objectives, not maximise ratings.
11. By competing so directly with its commercial rivals, the BBC has increased the difficulties which these rivals are currently experiencing. Fierce competition for audience share has been bedevilling advertiser-funded public service broadcasters. As a result, the BBC, with its ever-rising income, has come to play an increasingly dominant role in the provision of public service output. Two problems arise from this. The first is a growing threat to cultural and

political pluralism. The second is a decline in quality, as creative competition diminishes.

12. The justification for this state of affairs is that the BBC in its current form is an indispensable national institution. Its supporters maintain that only such an institution, publicly owned and operating on a grand scale, can fulfil essential functions. One of these is the provision of diverse, high-quality public service programming, which, it is often maintained, can only dependably be provided by large, integrated public-sector institutions like the BBC. It is believed that such institutions develop a unique culture which cannot be replicated elsewhere.

13. We considered this argument carefully, and rejected it. We did so partly on the basis of a study of Britain's own broadcasting history. Before ITV franchises were auctioned to the highest bidder, the ITV companies were able to develop a successful public service culture in the relevant programme departments, in spite of their relatively small size and supposedly commercial ethic. Today, small independent production companies manage to demonstrate a commitment to public service values that is at least the equal of anything which the Corporation can achieve.

14. It is also maintained that only the BBC in its current form offers Britain the prospect of producing a global media player capable of taking on Hollywood and extending Britain's world-wide economic and cultural reach. We rejected this argument too. State

corporations are inevitably conflicted. Many pressures dilute their capacity to maximise commercial advantage. The limited revenue available from the licence fee, and lack of access to capital markets, will constrain the Corporation's scope for expansion.

15. Public service broadcasting too might benefit from reduced dependence on a large, vertically integrated, essentially self-regulating institution already under criticism for lax standards. Its future might be sounder if its delivery were rooted in evidence-based assessment of needs and demonstrable quality, transparency, accountability and value for money.

16. We tried to approach the question of just what institutional arrangements might be most effective with as open a mind as possible. It seemed clear to us that our broadcasting industry must be as healthy and dynamic as possible, and as open as possible to new entrants, however small, from all quarters. There should be as little inhibition as possible on the free flow of creative energy. It also seemed clear that broadcasting should continue to inform and educate citizens as well as to entertain them, and that these public service tasks could not be entrusted wholly to the market.

17. For the delivery of public service programming, a completely new approach seemed to be called for. We felt that the whole idea of trying to force broadcasters to deliver programming which would depress their ratings should be abandoned

wherever possible. Public service broadcasting will only flourish if those engaged in it are fired by enthusiasm for their task, rather than left to discharge it half-heartedly. The way to achieve this seemed to be to provide a wholly new engine of motivation.

18. We also concluded that the advantages of size and integration that the BBC currently enjoys are outweighed by the benefits to society as a whole - economic, cultural and political - that would spring from liberating some of its components to become independent entities. A steady programme of divestment of production, distribution and ultimately even of certain broadcasting assets would be in the best interests of the nation.
19. We further decided that insofar as BBC activities should continue under the banner of a public corporation, the character of that corporation should change. It is not satisfactory that an institution as important as this one should operate under a Royal Charter, regulate itself and be run by a board appointed by the government. A new governance regime is required which complies with the standards of accountability expected elsewhere in contemporary British public life.
20. It was, however, the BBC's anomalous funding mechanism, and its constant campaign to sustain it, which we saw as the root of many of the current problems. The television licence fee is open to objection on the grounds of the inconvenience and cost of its collection, its regressive character and

its regrettable tendency to criminalise the poor. What is more, technological change may eventually undermine the whole idea of what constitutes a television set. And as multichannel viewing increases, people spend less time watching the Corporation's programmes, so resistance to the licence fee is likely to keep growing. The licence fee might therefore fail to provide the financial security which the BBC will require.

21. Abandonment of the licence fee for a more sensible means of funding broadcasting might also enhance prospects of a smoother and quicker transition to all-digital transmission of television programming, with the resultant savings that would arise from shutting down the analogue transmission system and releasing for other purposes the spectrum it consumes.
22. For these reasons, we concluded that trying to sustain the licence fee in the long term would be counter-productive, even for the BBC. We noted that within the Corporation itself there had been some who saw this as long ago as 1986, when the Peacock Committee considered the future of BBC funding.
23. Now that digital technology makes subscription a realistic alternative, none of us believes that the licence fee should survive another decade. We consider that payment for entertainment through taxation, particularly of such a regressive form, will no longer make sense when all consumers can pay directly for any

of the television programmes which they want.

24. However, although all consumers may in future be able to pay for entertainment, not all broadcasting is entertainment. Public service broadcasting entails the provision of "merit goods", intended to meet the needs of society and its citizens, rather than to satisfy the desires of individual consumers. We recognise that programmes in this category will always need to be funded by society as a whole.

25. We therefore propose that public funding of broadcasting should continue, but that, in due course, the mechanism involved should change. There is a belief that the licence fee system serves to protect the BBC from government interference. We do not share that belief, since the level and existence of the licence fee depend on government. We are confident that the arrangements we are proposing in its stead would make all broadcasters more independent, not less, than they are today.

26. There is no doubt that our proposals will provoke much resistance, both from those with a vested interest in the status quo and those with an understandable suspicion of change and wariness of the unanticipated consequences which it brings in its train. Nonetheless, we are confident that the steps we outline are in the best interests of both the nation and its broadcasting. That includes the BBC itself.

27. These four central themes - the continued health of public service broadcasting, the enriching of Britain's creative economy, the creation of a sustainable funding model for the BBC and the provision of the governing structures which these objectives require - are examined, respectively, in the four chapters that follow.

Chapter One

Public Service

Public service broadcasting is vitally important, but its future is threatened. Radically different ways of delivering it are required.

1. Introduction

- 1.1 One feature of broadcasting in Britain is the requirement that it should fulfil public purposes as well as satisfy personal tastes. As a state-owned and publicly-funded institution, the BBC has always been expected to play a prime role in what has come to be known as “public service broadcasting”. So Britain benefits from the provision of broadcast output that a purely market-driven system might not supply. This has included not just a wide array of news, current affairs and educational programming, but innovative, risk-taking entertainment as well.
- 1.2 However, there is no intrinsic reason why broadcast output, more than any other form of publishing, should be shaped by public policy. Many people would regard the intrusion of publicly controlled output into the print media as unnecessary and possibly sinister. We have no way of

knowing how much of what is currently state-supported would be produced anyway, if a genuinely free market existed. Current arrangements for determining how much public provision is required and of what kind are minimal.

- 1.3 In the age of spectrum scarcity, it was clearer that only action by the state could ensure that less obviously commercial material would find its way onto the airwaves. However, from the launch of ITV in 1955 and the arrival of pirate radio stations in the 1960s, Britain has enjoyed broadcasting from a growing number of commercial sources as well as from the BBC. As digital broadcasting has gathered pace, this process has mushroomed.
- 1.4 Today there are well over 300 television channels available to British viewers, including, for example, commercially provided arts and news channels. As output proliferates further, every indication is that commercial providers may supply more and more socially valuable information and debate of their own volition. It has therefore become necessary to re-evaluate the whole idea of public service broadcasting.

‘Broadcasters have got to be effectively rewarded, so that the provision of public service material becomes something that delivers them financial or strategic benefits, rather than a chore to be approached grudgingly.’

2. History

- 2.1 The BBC itself started in an entirely commercial environment. It was created in 1922 as the “British Broadcasting Company” by a group of wireless manufacturers aiming to provide programmes so people would buy their products. Nationalisation took place in 1927 largely because spectrum was scarce and needed to be managed so that signals did not conflict with each other. There was some concern about danger to national security in the face of political turbulence throughout Europe, as well as a desire that the new medium should be used to extend high culture to a wider audience. It was against this background that the state-owned BBC’s role was formulated: it was to provide what people ought to have as well as what they seemed to want. The second world war further entrenched the Corporation’s engagement with public purposes.
- 2.2 The BBC has always been expected to provide pure entertainment as well as improvement. For the most part, it has been allowed to “inform, educate and entertain” without too much

inquiry into the precise relationship between these different purposes. There seemed little need to separate them as long as all the nation’s broadcasting needs and desires were being met by a single institution required to shape output in accordance with the national interest. This was necessarily the BBC’s exclusive task as long as spectrum scarcity ensured there was too little room for rival suppliers.

3. A different future

- 3.1 Today, on the other hand, programming that people want to watch is increasingly being provided in the market-place either through advertiser funding or direct subscription by viewers. The government proposes that all television broadcasting should be digitally transmitted in due course. Once this happens, it will be possible for viewers to be charged for anything they watch that cannot be funded by advertising or sponsors. After analogue switch-off, there will cease to be a need for television programming to be provided free at the point of use by a public body unless there is a

genuine public policy purpose for providing it. It is therefore becoming increasingly necessary to establish what such purposes might be, if indeed they exist at all, and if they do exist, how they should best be fulfilled.

- 3.2 Nonetheless, such inquiry is resisted by some, particularly those anxious to preserve the status quo. The provision of entertainment which would be sustainable in the market-place is sometimes deliberately confused with the provision of public-interest material which might well not be. Yet while it is certainly possible for some programming to have both entertainment value and public purpose (and it may be desirable for as many programmes as possible to do so), these two things are distinct. It is necessary to separate them if proper judgments are to be made about what should and should not be publicly funded.

4. "Merit goods", "market failure" and "public goods"

- 4.1. Economists often describe public-purpose programming as a "merit good", by which they mean something which individuals (and advertisers) would not be prepared to pay for but the provision of which is in the public interest. Two other economic terms also appear in this argument and can give rise to confusion.

4.2 The expression "market failure" is reserved by economists to describe the situation that arises when the market fails to provide something not because consumers would not be prepared to pay for it, but because they are for some reason unable to. BBC Radio 4 (high-quality speech without advertising breaks) enjoys the support of an enthusiastic audience who might be prepared to pay considerable sums to receive it. Yet "conditional access" is not currently available for radio (which means that a subscription payment system would be unable to exclude "free riders"). So the provision of this service at public expense can be considered to remedy market failure. On the other hand, the cost of providing Newsnight might be difficult to recover in full from those viewers who would choose to watch it if they had to pay to do so. The case for public funding has therefore to be that it is a "merit good", benefiting society as a whole by its existence and not merely those who view it.

- 4.3 Because we have never known a broadcasting system in which the state did not participate, we cannot know for sure where market failure might occur if public intervention were not preventing it. We can, however, determine whether or not we think a particular programme has sufficient public value to qualify, if necessary, for merit good status.

- 4.4 Causing more difficulty in this area is another term which economists use - "public good". This sounds to the uninitiated as though it must be what economists actually call a "merit good". To economists, however, it means something very different, even though the argument that something is a "public good" is also a justification for funding it from taxation. To economists, a "public good" is something the cost of whose provision does not increase with the number of people consuming any given quantity of it. The presence of this characteristic can appear to justify the funding of broadcast entertainment from taxation even if entertainment is not considered a merit good, since charging individual consumers for such material involves a "welfare loss", because fewer people would watch it than would otherwise be the case.
- 4.5 However, the "public good" argument has lost most of its relevance to the entertainment industry as it functions today. This industry relies on the capacity to exploit rights in the intellectual property it generates, by charging royalties or licensing fees. Owners of such rights would tend to withdraw from channels based on the "public good" principle. If music and films were provided free at the point of use and funded by a public provider, either the tax burden would become insupportable, or value in creative work would have to be

expropriated. As it becomes easier to charge for television programming, the same logic is asserting itself in the broadcasting sector.

- 4.6 Behind all this jargon lies just one distinction which really matters in the argument about public service broadcasting. This is the difference between material which individuals (or advertisers) would be prepared to pay for, and material deemed to be of public value, sustainable only by public subsidy, and therefore a "merit good". At present, most of the BBC's activity falls into the former category, yet discussion of its activities sometimes gives the impression that all of it falls into the latter.

5. Backing for public service broadcasting

- 5.1 The ending of spectrum of scarcity was bound to call into question Britain's continued commitment to a public role in its broadcasting system. For example, in 2003, a report on the future of broadcasting from the Adam Smith Institute by Eben Wilson concluded: "There should be no requirement for any broadcaster to provide any public service broadcasting." Nonetheless, our own group took a different view.
- 5.2 We all agreed from the outset that British broadcasting should not only retain but strengthen its capacity to serve the public interest as well as to entertain listeners and

viewers. We also acknowledged that since some of the resulting output would be designed to further public purposes rather than to satisfy the desires of individual consumers, it would never make sense to attempt to recover the cost of such output directly from those who happened to view it or listen to it.

- 5.3 The case for retaining a public role in broadcasting while other forms of publishing remain free of such an obligation flows from the character of the medium. The audio-visual message has peculiar powers, some of which are particularly suited to public purposes. It can combine speech and images to achieve instructive and aesthetic effects beyond the scope of print. It enjoys the capacity for instantaneous transmission. It is capable of penetrating virtually every home, and in the most cost-effective way available. Nonetheless, the decision to require broadcasting to serve society as well as individuals is simply the choice of the nation that makes it, seeking to use its assets as it sees fit.
- 5.4 As we have said, we recognise that the ending of spectrum scarcity is likely to mean that some output which once required public funding will in future be provided in the market-place. Perhaps a great deal will be, but no-one can know for sure. Some "merit good" programming seems unlikely to be provided in adequate quantity and

quality, particularly material designed to help citizens participate in the democratic process. At a time when concern is being expressed about political disengagement, we decided that this factor was important. We therefore concluded that arrangements to ensure the provision of merit good material would be essential.

- 5.5 However, if broadcasting is to continue to be in part a public service, the delivery of this service should be subject to standards no less rigorous than those we expect to be applied to other public services. In particular, society ought to be able to secure the character and quality of output it requires, and to ensure that the quantity of provision is neither more nor less than what is required to meet such public needs as the free play of forces in the commercial market-place has failed to satisfy.
- 5.6 In a parliamentary democracy, the question of just what public functions broadcasting should be expected to perform is clearly a matter for Parliament. Our group inclined to the view that too many items have been allowed to accumulate in the list of public responsibilities enshrined in the current BBC Charter and Agreement. We would prefer a shorter list, and decided that our own priorities would be supporting the democratic process with a reasonable mix of debate and

information and protecting diversity of output. However, Parliament has just provided its own definition of public service broadcasting in the Communications Act 2003, and it seems inappropriate to revisit that as part of the Charter review process.

6. Existing weaknesses

- 6.1 The question we did have to address is what role the BBC should play after its current Charter expires in the performance of those public service obligations which have been laid on the broadcasting sector. Although other radio and television broadcasters participate in public service broadcasting, enthusiasts for the Corporation sometimes speak as if the entire job was down to the BBC. They often imply that discharging public duties in the broadcasting arena can be successfully achieved only by an institution exclusively committed to this purpose, ideally publicly owned and preferably tax-funded. This thinking leads them to the conclusion that successful public service broadcasting will depend on the current size, structure, funding and character of the BBC being preserved as far into the future as is possible. However, this view is far from convincing.
- 6.2 Even within the state-owned and publicly-funded BBC, the pursuit of ratings often seems to overwhelm Reithian ideals, as programming such as *Celebrity Sleepover* has amply demonstrated. Indeed, some critics consider that the BBC nowadays demonstrates more vigour and enthusiasm in the provision of popular entertainment than it does in discharging its obligations to educate and inform.
- 6.3 Equally, in the past, some of Britain's most effective public service broadcasting has emanated from commercial companies. Before the 1990 Broadcasting Act abolished the franchise beauty contest system, the public service output of the commercial ITV companies was often more serious-minded than that of the BBC. Much of what is today considered the best public service broadcasting (including material like *The Death of Yugoslavia* which is widely assumed to be BBC-made) is not made by the BBC at all but comes from private businesses operating in the independent sector.
- 6.4 We therefore concluded that the provision of high-quality public interest content does not necessarily depend on the preservation in aspic of particular institutions supposedly committed to delivering it.

7. Quality

7.1 On the contrary, there are indications that the current institutional set-up is actually part of the reason for the widely perceived under-performance of the BBC in the delivery of its public service remit. Recent complaints about the "dumbing-down" of supposedly serious content come at a time when the BBC has more money at its disposal to perform its public duties than it has ever had before. Though some attribute this paradox to the character of the Corporation's leadership or the weakness of the present regulatory regime, there are systemic reasons why it should instead be seen as a logical corollary of the current arrangements.

7.2 Like any institution, the BBC tends to put institutional purposes first. Although under-delivering serious programming may undermine the case for the licence fee in the eyes of the political class, many BBC executives have believed that what matters more is the popularity of the organisation among licence-payers themselves. They therefore tend to prioritise entertainment over information and education, and, perhaps even more damagingly, seek to make the information they do provide as popular as possible, even if this means draining it of much of its merit good value. The pressure to behave in this way increases with the size of the licence fee, which

may well have risen above £130 by 2006.

8. Pluralism

8.1 Beyond the issue of quality, the BBC's public service output poses a further problem. The steady increase in the BBC's income from its inflation-plus licence fee settlement has been accompanied by a fall in the income of the advertiser-funded public service broadcasters. This fall may prove more than cyclical, and the capacity of the BBC's public service broadcasting partners to deliver on their public remits seems likely to be squeezed as a result. This means that the BBC is coming to play an ever more dominant role in the delivery of public service broadcasting. We consider that the consequent drift towards single-sourced public service provision poses a threat to both cultural and political pluralism.

8.2 The BBC's efforts to maintain impartiality are not universally considered successful. It would be odd if they were so considered, given the magnitude of the task involved. This would matter less were the BBC just one voice among many, but will matter more if its dominance is allowed to grow further.

9. Finance

9.1 The delivery of public service programming in the UK currently depends on funding methods

which may prove incapable of sustaining it into the future. We explain why we believe this to be the case in Chapter 3.

- 9.2 Today, the BBC's output consists both of material for which consumers would be happy to pay (if a mechanism enabling them to do so existed) and "merit good" material provided in the public interest. The television licence fee currently funds both kinds of output. However, once it becomes possible for consumers to pay for the programmes they want, they should do so. Since there appears to be relatively little scope to increase advertiser funding of UK television, that implies that the BBC should go over to voluntary subscription to sustain the bulk of its output, once this is technically feasible. After the analogue signal is switched off, it should be feasible to charge for any television programming in this way (see Chapter 3).
- 9.3 It will be possible to begin progressing towards this objective as soon as the current Charter has expired. Arrangements by which this could be achieved are set out in Chapter 3. Should technology eventually provide a practicable means of charging for radio listening as well, then subscription should apply to that medium too. However, as yet there appears to be no visible prospect of this, so BBC Radio would need to continue to be funded for some time on a different basis from television (see 17.4).

- 9.4 If individuals should pay for their own entertainment as consumers, citizens should pay through the public purse for programming which they would not choose to buy, but whose transmission is deemed socially desirable by their elected representatives. It would be neither fair nor practicable to load the burden of delivering commercially unviable material onto a subscription broadcaster operating in the highly competitive pay-TV market-place. Any attempt to do so would exacerbate the pressures which are already leading the BBC to prioritise entertainment over public service.

- 9.5 However, if public service broadcasting is to be provided through an improved form of public funding, and if it is to win and retain public support through the 21st century, any new machinery will have to be transparent, accountable and visibly capable of matching funds to needs. A system that depended on handing over substantial sums of public money to a single, self-regulating institution to do with more or less as it wishes would not meet these requirements.

10. The solution

- 10.1 It seems clear that public interest content is not best generated through a "push" mechanism which tries to force broadcasters to deliver material they may not want to deliver. Instead, we need a "pull" mechanism. Broadcasters have got

to be effectively rewarded, so that the provision of public service material becomes something that delivers them financial or strategic benefits, rather than a chore to be approached grudgingly.

10.2 This solution must also enable broadcasters other than the BBC to play an enhanced role in the provision of public service content, both to guarantee diversity of voice and to drive up standards of quality through creative competition.

10.3 Furthermore, the solution must provide accountability and transparency. The nation requires a means of redistributing the public money available for public service broadcasting in a way that would address all of the above-stated concerns.

11. Contestable funding

11.1 In certain countries overseas, notably Singapore and New Zealand, public monies for the provision of public interest broadcasting content are distributed through systems of challenge funding which require applicants to demonstrate their suitability to discharge the functions in question in open competition against rival potential suppliers. A similar approach has of course become the norm for the distribution of public funds in fields other than broadcasting. A system of "contestable funding" of this kind for the generation of

public service programming ought to provide not only a means of guaranteeing diversity of voice, but also a way of ensuring high creative standards.

11.2 Competition in entertainment programming is achieved through the battle for ratings. Where ratings are not the appropriate arbiter of success or failure, this competitive spur is absent, and it is easy for standards to slip. Competition for funding would introduce a quality driver comparable to the pressure applied by ratings figures.

11.3 Furthermore, contestable funding ought to ensure that the provision of public money for broadcasting becomes efficient, transparent and therefore accountable. The current system effectively hands £2.7 billion a year of public money to the BBC to dispose of as it wishes, while it also provides free or cut-price spectrum to both the BBC and other broadcasters - all in return for public service undertakings which are difficult to police.

11.4 Another benefit of the provision of public funding to different broadcasters through a public body other than the government is that broadcasters' independence should be enhanced. At present, the government can implicitly threaten to reduce the level of the licence fee to intimidate the BBC. If instead the BBC received all of its public funding through an

intermediate body, the government's capacity to influence the ultimate destination of such funding would be minimised. In this way, the contestable funding body would effectively diffuse political pressure.

12. Objections

- 12.1 Objectors to the use of contestable funding have argued that the body distributing the funds would be subject to political pressures and incapable of exercising adequate creative judgment. They have also maintained that only broadcasters with a permanent obligation to deliver public-interest content would be in a position to develop the appropriate corporate culture, and to provide sufficient investment in development and training. None of these objections stands up well to scrutiny.
- 12.2 In so far as the body were subject to lobbying by interest groups, this would be an entirely legitimate process. It would be up to Parliament, in delineating the remit for public service broadcasting, to set objectives and priorities. So long as these were sufficiently clear, the distributing body would have no reason to pay undue attention to those who would inevitably and rightly press their suit upon it.
- 12.3 We do not believe that creative judgment can be exercised only by a priesthood of cultural professionals. Indeed, professionals

have shown themselves as capable of making mistakes as anyone else, and limitations on value of expertise in this sphere are openly acknowledged even by Hollywood's finest.

- 12.4 Public service broadcasting is unlikely to suffer from having an independent institution exclusively dedicated to promoting it. On the contrary, this ought to enable Britain to become the world centre of thinking about public service broadcasting and a hotbed of research, discussion and publication on this topic.

13. Operation

- 13.1 It can reasonably be argued that the disbursement of contestable funding for public service broadcasting, if it is to occur at all, should take place from within Ofcom. Ofcom will in any case have a responsibility to assess the delivery of public service broadcasting by ITV, C4, five and the BBC "taken together". It could then go on to ensure that what appears matches its assessment of what is required by supervising the distribution of the funds supposed to achieve this. That would be a convenient approach, but it would not necessarily be the right one.
- 13.2 Ofcom is a regulator, and is developing the culture to be expected of a regulatory body. Its principal concern is to exact compliance with the requirements of which it is guarantor. The body

which distributed contestable funding would need to be more proactive and creative in its approach. It ought to be given the freedom to develop the personality it will require, by establishing itself from scratch.

strictly enforced to prevent any kind of sclerosis setting in. The board should employ staff equipped with practical experience and expertise in the production, transmission and distribution of broadcast material.

13.3 In addition, the distribution of funds for public service broadcasting is itself an activity which ought to be properly regulated. If this did not happen, there would be a danger that the new system would be open to the same charge of unaccountability currently directed at the BBC. Ofcom ought therefore to hand over its assessment of public service broadcasting needs to a separate institution which should control the disbursement of public monies. Ofcom should then regulate this second institution as part of its overall duty of securing and enhancing public service broadcasting in Britain.

14.2 In response to Ofcom's assessment of public service broadcasting needs, the PBA would prepare a rolling plan specifying the kinds of programming it believed should be provided. The Authority would control no platforms itself. All broadcasters (including internet publishers and mobile telephony operators) would be allowed to bid for contracts to deliver public service programming. Producers, or the production divisions of broadcasters, would be able to tender to produce PBA proposals or originate proposals themselves, so long as broadcasting arrangements were in place.

14. The Public Broadcasting Authority

14.1 The new institution could be called the "Public Broadcasting Authority" (PBA). It should have a board mandated only to implement the public service broadcasting objectives defined by Parliament, rather than to represent regional, gender, ethnic or other interests. Appointments could be made initially by Ofcom and subjected to approval by a Parliamentary committee. Terms would be of limited duration and turnover

14.3 The bidders presenting the most attractive and cost-effective proposals would then be commissioned. Contracts could run for whatever period seemed appropriate. In some cases this might need to be several years. Large volumes of output would doubtless be recommissioned on a rolling basis.

14.4 Where the public interest would be best served by the maximisation of audience size, the PBA could specify that programming it was supporting must be transmitted unencrypted. On the other hand,

if it wanted, say, to stimulate the production of original comedy, it might decide this would best be achieved by part-funding subscription programming.

- 14.5 Ofcom's public service broadcasting reviews would effectively deliver a verdict on the success or otherwise of the PBA's decisions. Sanctions available to Ofcom in regulating the PBA should include the power to sack its board members if it believed they had under-performed.
- 14.6 The PBA's prospects of success would be enhanced by the efforts suppliers would make in the hope of being recommissioned and by the competitive pressure from rival potential suppliers. Doubtless long-term relationships would develop between key suppliers and the Authority, as particular organisations developed demonstrable strengths.

15. Funding

- 15.1 Funding for the Public Broadcasting Authority could be raised within broadcasting, perhaps from spectrum charges or VAT receipts from digital television subscriptions. Some argue that an "automatic" mechanism of this kind would protect public service broadcasting from attrition by governments which would otherwise whittle down its receipts. Public funding for the Public Broadcasting System in the United States was cut during the

Reagan era. Nonetheless, conditions in Britain are very different from those in America. Here, the tradition of public service broadcasting is well established in a way it has never been across the Atlantic.

- 15.2 It should therefore be practicable for the Public Broadcasting Authority to be funded by a grant from the Exchequer, like any other public body. Indeed its claims on the public purse ought to be measured against those of schools, hospitals and defence. If public service programming is worthwhile, it should have nothing to fear. The Chancellor should ensure that the degree of funding provided would be no greater than evidence-based assessment suggested was required.
- 15.3 After devising and costing its plans, the Public Broadcasting Authority would prepare a bid for the funding it considered it would need for several years. It would then present this to the Treasury, and negotiations would ensue. These discussions should be as public as possible, and the relevant correspondence between the Authority and the Treasury should be published. Once a long-term plan was in place – and we suggest five-year rolling funding – it should be reviewed as part of the annual spending round.

16. The tax base

16.1 Funding public service broadcasting through an Exchequer grant should not entail tax increases. The licence fee should therefore continue for as long as it would be needed to ensure that increases in other taxes would not otherwise be required. However, licence fee revenue would go to the Exchequer rather than directly to the BBC, which would receive all of its public funding through the PBA.

16.2 As the BBC's television services came to be funded increasingly by subscription (see Chapter 3), its need for public funding would steadily drop, since television broadcasting is by far its most costly activity. The level of the licence fee could fall in step with this process.

16.3 Once analogue switch-off allowed the BBC's television entertainment broadcasting to become entirely funded by subscription, it ought to be possible to abolish the licence fee completely. Funding for merit good content provided by the BBC and other broadcasters through the Public Broadcasting Authority would be largely offset by revenues arising in the broadcasting sector from sources other than the licence fee. Market-rate spectrum charging is to be imposed on those broadcasters currently receiving free or cut-price spectrum, and VAT income from pay-TV subscription seems bound to rise considerably.

17. The BBC and contestable funding

17.1 Once the BBC's television services had become digital-only and principally subscription-funded (see Chapter 3), they would have to compete for subscribers in the pay-TV market-place. If they were also obliged to provide merit good content, they would be at a considerable disadvantage. The pressures which currently lead the Corporation to try to maximise ratings to the detriment of public service functions would therefore be even stronger than they are now. So these television services should be released from public service obligations once they become subscription-funded.

17.2 Instead, public service broadcasting should become a voluntary but potentially profitable activity for BBC Television, as it would for other broadcasters. All would be free to apply to the Public Broadcasting Authority for money for merit good provision. There is every reason to suppose that the BBC would seek to capitalise on its experience in this field by participating energetically in this process. It would also be able to continue to offer programming which combines public interest and entertainment value by seeking part-funding for such output from the Public Broadcasting Authority.

17.3 Between 2007 and the beginning of analogue switch-off, the BBC

would of course still be looking to the PBA to provide funding for much of its television entertainment, though we envisage it attracting some digital subscription funding during this period (see Chapter 3). Since it would also be requiring PBA funding for its radio and internet services and merit good television programming, it would become the PBA's principal client in these years, with only a relatively small amount of money being available to float contestable funding for other broadcasters. This situation would minimise disruption and provide an opportunity for experience of the workings of contestable funding to be built up gradually.

17.4 Because there is no immediate prospect of technology emerging which would provide conditional access for radio programming, we envisage that all of the BBC's radio services should be financed through the Public Broadcasting Authority for the foreseeable future, even though they form a mix of entertainment and public-interest material. The PBA should keep a close watch on public service radio. It should use its funding power to ensure the provision of rival services to those now offered on a near-exclusive basis by BBC Radio, should this come to be desirable.

17.5 The BBC's internet services and any services it might develop on other new platforms should be eligible

for funding from the PBA on the same basis as its other broadcasting services, as should any such services provided by other organisations.

18. Other broadcasters

18.1 Although this report deals with the BBC, its proposals have implications for other public service broadcasters. It would make sense for ITV and five to be released from their compulsory content requirements, and invited instead to seek contestable funding on a purely voluntary basis. All commercial broadcasters should be able to compete for funding from the Public Broadcasting Authority, including those which have not been required to deliver public-interest content before. Spectrum charging will require ITV and five to pay increased sums to the Exchequer, and the financial benefits from the removal of public service programming obligations should compensate for the higher fees.

18.2 Uniformity of approach might appear to require that Channel 4 be stripped of its public service remit so it could operate freely as a minority-oriented, advertiser-funded broadcaster, entitled to seek funding for public interest material from the Public Broadcasting Authority. There is nonetheless a case for retaining Channel 4 as a state-owned, commercially financed, remit-driven channel. Channel 4

is not so large that its activities distort the broadcasting economy significantly, nor does it pose a disturbing threat to plurality of voice, nor has it been subject to the same degree of criticism on grounds of inefficiency, perhaps partly because of the market discipline to which it is subjected.

- 18.3 Channel 4 should be allowed to apply like other broadcasters to the PBA for funding, where it can make a convincing case for projects which it would not otherwise be able to afford. The introduction of spectrum charging should apply to Channel 4 as to the other broadcasters, and the possibility of receipts from the PBA should mitigate the impact of this. In the longer term, the future of Channel 4 would no doubt be reviewed as the broadcasting environment changed around it.

strengthen delivery. Complaints about mediocrity and dumbing down should dwindle. An externalised decision-making process subject to external scrutiny would be easier to justify to a sceptical public. An evidence-based system for the determination of the character and quantity of publicly-funded output would ensure that all could see what was being provided and why.

19. Conclusion

- 19.1 These proposals turn on their head many current ideas about how public service broadcasting is expected to operate. Nonetheless, they offer a basis for ensuring that the public dimension of our broadcasting system should remain as effective as is necessary throughout the digital age.
- 19.2 Public service broadcasting would be reinvigorated by the impact of enhanced competition and increased diversity of supply on both plurality and quality. Secure, transparent funding would

The Creative Economy

The BBC is a key part of the creative economy, but its structure and policies do not serve the best interests of the creative community. A new structure would release the creative flows in the industry and resolve long-standing complaints of anti-competitive behaviour by the BBC.

1. Background

- 1.1 The BBC is the UK's pre-eminent broadcaster and dominant public service content provider. It is also a major cultural institution, a "national champion" and a unifying political force. Many believe it is the bulwark of truthful reporting against the "spinners" of Whitehall.
- 1.2 The BBC is also our biggest producer of television and radio programmes, our leading distributor of those programmes, a major broadcast platform operator, a leading internet portal, a significant publisher of consumer magazines and books, the owner of the most production studios in the UK and an important source of personnel and training for the industry. The creative economy is larger than BBC television and radio: but in those vital parts of the creative economy, the BBC is dominant.
- 1.3 Where does the public interest lie in all this? Surely, not in its dominance as such, but in ensuring that the BBC continues to be a premier British institution while making a key contribution to the British creative economy as a whole. For this reason it must be positioned within the creative economy in a way that enables it to realise its own ambition without restraining the contributions of others.
- 1.4 That economy is undergoing rapid and recent change permitted by the adoption of new technology – most significantly new and very substantial sources of revenue, principally subscription, and the increasing centrality of intellectual property rights.
- 1.5 Broadcasting now draws revenues from three major sources: licence fees, advertising and subscription. Broadcasters are dependent on these three separate sources, either singly, as is principally the case with the BBC's licence fee, and advertising for ITV, Channel 4, five and commercial radio; or as a combination of subscription

‘The BBC maintains a vertically integrated structure which seems at odds with modern economic realities, free market competition and optimised benefit to the nation.’

and advertising as is the case with many in the multi-channel television market. Each broadcaster is therefore subject to different pressures and has different objectives.

- 1.6 Advertiser-funded channels strive for maximum audiences, generally broad-based in character. These broadcasters enjoyed significant advantage when channels were few, and large audiences gathered to watch general interest programming. The “coverage” of such channels has been eroded with the proliferation of smaller channels (and sets in the home), allowing individual members of the household to watch different programmes on different television sets within the same household. Smaller channels are rarely dependent solely on advertising. When they are, they tend to attract different types of advertisers, addressing the viewers who have been diverted from mass audience channels.
- 1.7 The BBC, funded almost entirely by the licence fee, has a different objective. The emphasis is on inclusiveness. It relies on its ability to provide something for everyone.

Hence, the BBC rightly emphasises “reach” rather than “ratings” in justifying its performance, since reach measures the percentage of the total population that has watched something in a given period whereas ratings simply measure the size of a particular audience at a particular time.

- 1.8 The third revenue source, subscription, is a relative newcomer. But it has had a dramatic effect on television’s gross income, recently moving ahead of advertising as the largest single revenue source in British broadcasting today. Nor has it grown at the direct expense of either of the other two revenue sources. It has tapped the new money that viewers are willing to put behind their own personal choices, selected from a range of options that were simply unavailable in the early days of television. Most people in the industry freely admit that the revenues subscription has liberated are greater than they expected.
- 1.9 This new money has had a different impact in different environments. Today, the benchmark for quality in

sophisticated dramatic writing and innovation is being set by programmes such as *The Sopranos*, *Sex and the City* and *Six Feet Under*. These originate on an American subscription channel. As a secondary effect, the high standards set by this work have raised the bar on other kinds of channels too. Thus new revenues, as so often happens, have generated a stimulus for innovation and dynamic creative development.

- 1.10 In the UK, subscription revenues have taken us in a different direction, with emphasis on sports and films, which these new specialised channels provide on a dedicated basis. The impact on creative activities such as drama and comedy so far has been negligible, not least because such categories are extensively provided on free-to-air channels. It is perfectly legitimate that these revenues should go into sports and film rights, but we would like to see more of them move into other areas of creative production, and believe our funding proposals outlined in Chapter 3 would assist this process.
- 1.11 The BBC has, in the main, denied itself this potential revenue source, opting for continued dependence on the licence fee and committing itself to a “free” digital terrestrial television platform. However, its joint venture with Flextech, UKTV, is partly financed by subscription, and has shown that BBC content

(which dominates the schedules of this service) can be attractive to paying audiences even on repeat.

- 1.12 The creative economy’s value chain has been transformed by new technology which has ended spectrum scarcity. In the age of spectrum scarcity the most powerful link in the value chain was the channel and its licence to broadcast. Channel supply was limited by spectrum availability and was low. The broadcaster’s power was reinforced by vertical integration into production, distribution and facilities ownership.
- 1.13 We are now in the age of spectrum abundance. The channel is still an important asset, but of declining value as new delivery systems like cable and satellite and less expensive digital technology make markets more accessible and lower the cost of broadcasting. This makes it easier for new channels to be established.
- 1.14 The result has been increased competition, and arguably more choice for viewers. The one cost that has not diminished for channels - and has in fact increased as a result of competition between channels - is programming. This is why power is transferring from the broadcaster and channel owner to the content producer and why the most important asset in the value chain of the multi-channel age is the ownership of, and right to

exploit, key content properties, films or programmes with global audiences. Formats such as *Who Wants to be a Millionaire?*, animated series such as *Bob the Builder*, and high-end documentaries such as *The Blue Planet* can be exploited all over the world, carrying Britain's creative reputation with them, generating very significant export earnings, and helping to turn Britain into a hub of the global entertainment economy.

- 1.15 All change has unanticipated consequences, but these changes have been positive. They have extended choice for the consumer and helped the UK to prosper as an international player. However, not surprisingly, these changes have not always been welcomed by the established major players, including the BBC. Organisations have a right to resist developments that oppose their interests, but competition regulators exist to keep this resistance from pre-empting benefits to the public. This resistance has been reinforced by the dominant positions held by leading players and by the support they receive from a regulatory system that extends benefits and privileges in return for public service broadcasting responsibilities. Where intellectual property rights are concerned, the BBC has shown clearly that its priorities have been control of as many rights as possible and exclusivity of use on its channels. Recently this priority has been

successfully challenged by producers wishing to manage the control and exploitation of the programmes they have developed and made.

- 1.16 In spite of these significant changes in the market – on the one hand the expansion of choice in multi channel television and its growing economic power in the form of subscription revenue, and on the other hand the shift in economic power from broadcasters and channel owners to content producers – the BBC maintains an 80-year-old funding mechanism and a vertically integrated structure which seems at odds with modern economic realities, free market competition and optimised benefit to the nation. We think the BBC is mistaken in this. It is bad both for the BBC itself and for our creative economy. The BBC enjoys positions of market power across a broad range of activities, a situation which is unique when the rest of the broadcasting industry has become subject to the same competition rules as any other industry. It also impedes the creative industry that has so much to offer the UK in terms of competitive advantage and quality of life.

2. Scale and scope

- 2.1 The scale and scope of the BBC's current operations are a product of its long-standing belief in the power of vertical integration in the broadcast industry. For decades,

the BBC and ITV maintained parallel armies of facilities, training, in-house production, support services (such as sub-titling), departments for all categories of programming, broadcast executives and distributors.

- 2.2 For decades, this arrangement persisted, with little transfer of personnel (save for the initial setting up period for ITV) between the two entrenched systems. External costs were controlled: a “gentleman’s agreement” (an effective cartel) applied to acquired series and potentially expensive rights, such as League Football.
- 2.3 Independent producers were actively discouraged. The overall picture remained largely unchanged until the launch of Channel 4 in 1982. Channel 4 out-sourced all production, and helped convert the small group of independent producers who existed in 1982 into the cohort that contributes so much to the creative economy today.
- 2.4 Yet, for some people, the integrated model remains preferable. Inside the BBC, there is a view that more control is possible with in-house production, and there is no loss of ownership and rights revenue. Others argue that the BBC is only able to play the role of national champion and cornerstone of the broadcast industry because of its scale and scope. These, it is claimed, give it

strategic clout and vision, allow it to take centre stage (as opposed to the sidelining of public broadcasters in many other countries), deliver efficiencies, and maximize value to society as a whole, as opposed to private interests. This has for a long time been a persuasive case, but it is not one we think is appropriate to the future digital age.

- 2.5 Nor do we accept that there is any evidence of cost efficiency from vertical integration or from operating across different media. This raises the question of value for the licence payer in the BBC’s proliferation. If anything, there is evidence of inefficiency, and of unduly enlarged bureaucracy, some of which results from unwieldy attempts to unify disparate activities, and more of which flows from the desire to create corporate policy and strategy. Even after the overhead cuts pursued by Greg Dyke, the BBC’s bureaucracy still absorbs some £400m a year.
- 2.6 Two further problems arise from the BBC’s current scale and scope. The first is the sourcing of BBC output: if too much comes from in-house production units, there is a danger of a lack of diversity of output. The second is in the sheer size of the BBC share of voice across platforms: this threatens pluralism.
- 2.7 Acceptance of the view that the BBC needs exceptional size and scope means its ability to grow is

not subject to normal market constraints where the capital markets support effective managers and proven scope for improved performance. Rather, the BBC's growth is driven by its political skills in winning revenue increases and approval for new ventures from the government of the day. And the government policy of identifying and supporting a single national champion is a discredited strategy that was abandoned in other areas over thirty years ago. Its faults were manifested in organisations that grew top-heavy and slow to adjust. We see the same problems in the BBC. We too are keen to see the long-term investment in the BBC – and, more importantly, the BBC's current skills and assets - put to optimum use. We believe that our recommendations will deliver a stronger and more valuable BBC, more coherent and cost-effective public service broadcasting, and a more vibrant creative economy.

3. The case for change

- 3.1 Our approach to the BBC's future role after the current Charter period has been to balance three overlapping considerations: what is best for public service broadcasting, what is best for the BBC and what is best for the creative community as a whole. Implicit in such an approach is that the three do not necessarily coincide.
- 3.2 In our first chapter, we looked at public service broadcasting as a provider of programming of social value that the market might not generate. We examined the dangers of over-reliance on a single provider of a system of delivery that lacked transparency and accountability.
- 3.3 This exposed one area of tension between the BBC's corporate ambitions (in themselves understandable and legitimate) and the needs of society as a whole. For many decades, we have taken for granted the centrality of the BBC to our broadcast system, accepting – even welcoming, for the most part – a steady expansion in its activities
- 3.4 The BBC sometimes argues that this expansion helps it fulfil its public service objectives. We have dealt with this issue in Chapter 1, where it is made clear that we see many flaws in this position. From an economic standpoint, there has been a steady rise in complaints about the BBC's burgeoning activities, and a growing realisation that the BBC's corporate interests could clash not only with those of its commercial competitors, but with the creative community of which it forms only a part. In our view, if left unaddressed, these complaints will substantially increase in number and threaten the trust which the public and industry alike have for the BBC.

- 3.5 We question not just whether the BBC should continue to expand, but even whether it should stay as large as it is, and retain its current structure. Far from accepting the old rule of thumb that the BBC should match the size of its competitors combined (which is roughly the case at present, in terms of audience share), we can see problems that arise directly out of the BBC's current scope and scale. Where there is a clash of interest between the BBC and the larger creative economy, our conclusion is that the needs of the creative economy should prevail.

4. The BBC and the public interest

- 4.1 When broadcasting was limited by spectrum scarcity, it may have been reasonable to look to a publicly owned, non-profit-making body to protect the public interest by covering a wide range of output, including less popular but socially valuable categories. What we have seen over the years is that the BBC's own corporate ambitions to remain the core protector of public interest in broadcasting have transferred undiminished to the digital age, where there is no spectrum scarcity and where much BBC output is largely indistinguishable from that of its rivals.
- 4.2 This is not a comfortable thought. BBC executives sometimes recoil at the suggestion that a particular BBC policy might be helping the

BBC but hindering the broadcast industry as a whole. As a public servant, the BBC maintains that it serves only the public's interest. It argues that using its clout to commission its programmes on the best terms possible from independent producers, extracting rights value from ancillary markets and expansion into new markets are all in the long-term interests of the public. But the BBC must be sure that there is no superior way of extracting that value, and that the process does not damage other legitimate interests more than it benefits the BBC.

- 4.3 In the past the BBC has confused its own self-interest with the higher public interest. The BBC fought bitterly to preserve its monopoly of broadcasting during the Beveridge Inquiry of 1949, and persuaded most of that panel's members of the virtues of its case. Only a lone Conservative back-bench MP, Selwyn Lloyd, preferred the simple benefit of plurality of voice to all the merits of the BBC. In the end, it was solely thanks to a change of government that the monopoly was broken. Even a decade later, the BBC had still not conceded that it was wrong.
- 4.4 The plurality of voice argument is as valid today as it was in 1949. Now, it is not monopoly power that needs to be challenged, but the powerful interaction of a set of overlapping dominant positions, in television, radio and the internet, which can be and are leveraged to

- the detriment of other voices and the quality of our cultural and political life. The BBC's vertical structure and its dominance of the facilities, production and distribution markets are a danger to other parts of the creative industry.
- 4.5 The BBC has regularly been on the wrong side of the pluralism argument. It opposed the launch of Channel 4 as we now know it, it campaigned against the spread of cable, it only supported satellite broadcasting when it was temporarily in control of UK satellite policy, and it resisted for many years any concession to independent producer access. In a more recent example, the BBC has failed by increasingly large margins to meet the 25% independent quota imposed on it by government even though this quota excludes large areas of output, and applies only to origination, other than news.
- 4.6 John Birt's famous rejoinder to the BBC's critics was that the BBC's very existence distorts the market, and was intended to do so. This carefully missed the point. Dominant positions are not in themselves automatically wrong: it is the abuse of dominant positions that causes damage. What creates concern is the series of dominant roles, in different markets and on different platforms, which the BBC is able to and does exploit.
- 4.7 The BBC's self-imposed (and self-policed) fair trading rules are not accepted by the commercial community at large as adequate protection against policies driven by the BBC's special structure. Those responsible for the management of the BBC, the Governors, are also placed in the impossibly conflicted position of providing regulation as well. Professor Richard Whish's Review of the BBC's Fair Trading Commitment and Commercial Guidelines underscored this concern when he concluded that "the crucial issue is whether the BBC has implemented and will continue to implement an adequate compliance policy to ensure infringements of the competition rules do not take place. A commitment to fair trading must be supplemented by adequate measures to ensure that compliance is maintained."
- 4.8 Further, despite being the largest of all cross-media owners, the BBC is regularly excluded from legislation and regulatory activity in relation to media ownership on the grounds of its non-commercial ownership. The EU explicitly allows the BBC (along with other public service broadcasters in Europe) to ignore Treaty of Rome rules on collective purchasing, because it ostensibly acts in the public interest.
- 4.9 However, the current wisdom maintains that a mixture of self-regulation and limited external

regulation will be sufficient to police and monitor the market behaviour of an organisation dominant in many spheres of activity. We think this approach is wrong.

5. The independents

5.1 Ofcom is in the process of negotiating new terms of trade for independent access to the major broadcasters, including the BBC. These are designed to prevent reported abuses faced by independent producers, either in manipulation of various fees or pressure to hand over rights. This may improve behaviour, but the fear must be that the regulator will be unable to monitor effectively this type of behavioural remedy. Nor is it clear that there are any effective sanctions for breaking rules.

5.2 The fact that the 25% independent access quota has been repeatedly flouted suggests that such failure reflects BBC policy, not just an accident of history. In any event, even meeting the quota would strongly suggest that there is an entirely artificial level of competition between independent producers (however efficient or creative, limited by the 25% ceiling) and in-house producers (however inefficient and imitative, guaranteed 75% of output). This is not a matter of fair terms of trade, but constraining the creative economy for the narrow benefit of the BBC. Even if Ofcom were to

be more successful than the government in enforcing the quota, or improving terms of trade for independents, it would still be patrolling the borders of anti-competitive behaviour rather than dealing with its source.

5.3 A second cause for concern is one that economists will recognise from Ofcom's frustrating attempts to deal with BT. As long as the BBC maintains a significant in-house production entity, the fee sought by an independent producer can always be compared internally (away from prying regulatory eyes) with the cost of a similar programme produced in-house. Because in-house accounting is rife with opaque cost allocation across platforms and activities, the cost of an in-house production will be a matter of discretion. This results in the independent being offered a low price – closer to marginal cost than full cost. In those circumstances, where the BBC is itself a major producer, and where its internal economics are less than transparent, the independent, regardless of the issue of secondary rights, will rarely be able to achieve a reasonable operating margin. This is what the Independent Television Commission was repeatedly told when it investigated the market and the many allegations that the BBC was abusing a dominant position.

5.4 The quota would only be worth pursuing if there were fair and transparent creative and price

competition. Yet it is the same BBC commissioning executives, tasked by their Director General to maintain the level of in-house production (without which the burden of overheads would become wholly insupportable), who decide on the merits of external ideas as well as of those generated by their own in-house colleagues.

- 5.5 As for pricing, it would be necessary through external regulation to ensure that independent producers were offered long-run average costs for their productions, not marginal costs. The importance of this issue cannot be overstated. Independent production companies must receive the full long-run average cost for their product in order to ensure a sustainable and economically healthy independent production industry. However, even in an industry such as telephony where creativity does not play so crucial a role, the regulator found myriad challenges in policing this type of system, and was constantly chasing the tail of the offending organisation.
- 5.6 Thirdly, there is the potential for the BBC to use its dominant market position to act anti-competitively. There have been many reports from the independent sector of BBC malpractice in commissioning. One producer, when challenging what he saw as the blatant

illegality of BBC accounting, was told that all the underlying documentation would be changed if he persisted with his challenge. He was forced to re-mortgage his house to fund his legal costs before the BBC (having been advised by outside lawyers to settle) abandoned its case at the doors of the court, picking up a bill in excess of £500,000. Several of the BBC's most senior executives were aware of this matter and declined to intervene.

- 5.7 But the biggest problem is neither cultural nor behavioural: it is simply the power of the BBC's distribution arm, BBC Worldwide. In the past its distribution strength has given the BBC dominant advantage with independent producers by often and effectively making distribution of an independent producer's secondary rights a condition of a UK programme commission. This effectively denies the producer fair control and exploitation of his intellectual property while at the same time allowing the BBC to recover much of the cost of the commission in distribution profits. Confronted with the BBC's behaviour and the frustrating lack of market alternative, the producer has often had little choice but to agree terms on these conditions. It was these very concerns, highlighted by the ITC's Programme Supply Review for the DCMS, which forced the BBC, along with other broadcasters, to adopt a new code of conduct that

complies with practices that had long been standard operating procedure for the ITV Network.

contributors to that content who are denied secondary revenue and public visibility of their work.

5.8 Rights management by the BBC is not only a matter of direct economic exploitation but also one of strategic control. BBC Worldwide manages a huge portfolio of BBC assets but it often uses this control to ensure that a programme is never broadcast on a secondary UK channel other than one part-owned by the BBC. When Channel 5 asked to license – as a tribute to Jacob Bronowski – the series *Ascent of Man*, Worldwide declined to do so, and so as to avoid criticism from the Bronowski family, then shoehorned the series into a mixture of slots on UK Horizons and BBC2 (at 9am on Saturdays), for a fraction of the revenue and to a much smaller audience than would have obtained on Channel 5. The audience, third-party rights holders and the licence fee payer were all short-changed in the process.

5.9 In the past The History Channel, Artsworld, Granada Plus, Nickelodeon and Sky One have all complained of the near impossibility of licensing BBC programmes, which are instead withheld for use only on BBC-owned outlets. Far from maximising revenue from the BBC's rich archive, for the benefit of all licence fee payers, the BBC hoards material, to protect its own interests. This is very much to the detriment of the creative

6. The creative issue

- 6.1 Whilst the BBC notes that the UK spends more per head on original television content than any other country, the US overwhelmingly out-performs the UK in the key areas of drama and comedy. TV critic after TV critic lauds the achievement of *The West Wing*, *The Sopranos*, *ER*, *Six Feet Under*, *Law And Order*, *CSI*, *24*, *The Simpsons*, *Friends*, *Seinfeld*, *Curb Your Enthusiasm*, *Frasier*, *Sex And The City* and innumerable other series, some of which can run to more than one hundred episodes.
- 6.2 We have already suggested one specific reason for this UK under-performance: the way in which subscription revenues, in the UK, have not been allocated to the production of innovative new drama and comedy. But the differences between the US and UK creative economies go much wider and deeper.
- 6.3 In the US, creators – writers and producers – have real clout and are rewarded accordingly. For many years, networks had limited rights on series, which were exploited to the full extent of their market value once network exclusivity had expired. Special rules were devised to allow this market to grow, and enable distributors to underwrite deficits on shows with confidence

that these could be recouped in the secondary domestic market, and thereafter earn yet more profit from exploitation overseas.

- 6.4 The rules have since been changed to allow networks to own more of their own shows, but the major producers who also own networks (Warner, Fox, Universal, Disney, Paramount) would never consider restricting their creative production arms to serving solely their own outlet. What the BBC routinely does to the creative community in the UK would result in a blizzard of lawsuits in the US. The studios, whether or not they own networks, have no doubt about their primary activity: the creation of great programmes with long life expectancies.
- 6.5 The extraordinary fact is that the biggest single production company in the UK makes programmes only for one buyer. Even when a show to which the BBC holds rights has finished its useful life on BBC channels, it is not released to other broadcasters, but simply terminated. The writers, performers and directors who have invested many years in a creative endeavour are blocked from any further exploitation of it. This suppression of the free flow of the creative process serves no-one other than the BBC. It is a policy applied nowhere else in the industry.
- 6.6 Releasing the creative energies in UK television production and

distribution is the key objective, and its pursuit is well worth the sacrifice of some secondary corporate objectives. The whole creative economy would experience a tremendous boost from a new openness of BBC schedules to all comers, and the availability of BBC production talent to all broadcasters.

7. Structural change

- 7.1 Because the quotas are subject to behavioural abuse, because in-house production suppresses healthy creative competition and supports opaque inefficiency, and because the BBC's vertically integrated distribution and production structures lock up the free flow of rights and ideas, we conclude that the creative economy requires structural, not behavioural, changes in the BBC. We therefore recommend divestment of the distribution and production functions of the BBC, leaving the core broadcast activity as the remaining key function.
- 7.2 Without an in-house distributor to allow it to control elements of the value chain, the BBC would no longer be able to distort either the independent production market or the secondary broadcast market. Without an in-house production business, BBC Broadcast commissioning editors would be able to take decisions on merit, and BBC Broadcast managers would have full transparency of content costs to the business.

- 7.3 Core rights would reside with producers, not the broadcaster, and would be properly exploited, to the benefit of the consumer and the creative community. The cost of transmitting programmes might rise, but would be constrained by increased competition in the market. At long last, we would have a reward structure that serves the viewer and the creator, not just the intermediary broadcaster.
- 7.4 Divestment of Worldwide would almost certainly lead to greater efficiency in that organisation, and allow it to tap the capital markets in the normal way to finance its activities. Separation from the BBC would give greater confidence in its distribution skills and independence of function to the independent sector.
- 7.5 Our view is that all the BBC's commercial activities other than domestic broadcasting should in due course be divested: to that extent, Worldwide is a paradigm for BBC Commercial Holdings as a whole.
- 7.6 Divestment of BBC Production may require an initial period before these assets are sold in which a substantially increased quota is introduced as an incentive to the BBC to proceed with divestment promptly. However, forcing up the quota may have a damaging effect on the BBC's own creative employees if their fate is driven by increasing pressure on BBC marginal costs in the face of declining output. We would rather see a rational and coherent solution to this problem instead of one dominated by arbitrary targets. In any event, for increased quotas to be effective they would have to be accompanied by a strict cost account system.
- 7.7 There may be a case for certain parts of BBC output to remain as in-house production. If so, the BBC can argue the case, and it can be judged on its merits. We make no presumption that news or current affairs would fall into this category. But the principle should be clear: we wish to maximise transparency in the BBC's activities, and to release the flow of natural talents within the creative community.
- 7.8 We accept that, unlike television, radio has little prospect of being able to tap into subscription revenues. To that extent, BBC Radio and Television are anyway likely to take divergent paths. In advance of that, and consistent with our proposals in Chapters One and Three on public service broadcasting and funding, BBC Radio should also be operationally separated from BBC Television even while they remain in common ownership. There is very little overlap between the two broadcast activities that could not be negotiated between two independent organisations. Such separation would clearly aid plurality of voice. However, we acknowledge that continued vertical integration makes sense in

radio where it does not in television. Additionally, each could maintain a separate online presence in the future, subject to funding, thereby addressing complaints from the online industry that the BBC has spread beyond its early modest proposals to become the largest information-based UK service provider.

- 7.9 Given the difficulty of financing public service radio other than through central funds, we have assumed that the PBA would negotiate with BBC Radio and the Treasury the appropriate level of activity undertaken, and the number of channels required. In the course of that process, we would expect the issue of how to release the skills and creativity within BBC Radio to enrich the radio industry as a whole to be assessed.

8. Transition issues

- 8.1 It will be for the competition authorities to judge whether BBC Production is too large to be released into the market as a single entity. If it were so judged, we would expect units of production to emerge, probably based on geography or genre. These divestments would need to be negotiated between experts inside and outside the BBC. It might be prudent to release one or two pilot entities in 2006, so as to gauge issues of market value and transition (such as pension

entitlements). We would expect full divestment to be achieved soon after the current Charter period ends.

- 8.2 This would give the capital markets time to calculate value, and should also stimulate the existing independent sector. Some independents, no doubt, will have business concerns regarding the significantly increased supply of such expert and substantial production units, able for the first time to compete across the industry. However, in return, the independent sector will gain full access to the BBC's schedules.
- 8.3 We have considered whether the BBC should be allowed to – or encouraged to – offer medium-term security to the divested production units. This would certainly increase their sale value, and ease some of the likely transition problems. The potential benefits of doing this, however, need to be balanced against possible distortions to competition in the market.
- 8.4 There will also be issues about continuing series. In our view, the object is not to create sudden increases in value for creators – and turbulence in the broadcast market – through a one-off event. If BBC1 wishes to retain *EastEnders* or *Casualty* for the medium term, it should have the right to negotiate to do so, on a cost-plus basis, rather than a market value one. After an agreed period of

time – perhaps after the expiry of the licence fee itself, which we deal with in Chapter 3 – market value should prevail. By then, BBC TV Broadcast should have shifted to a value-based funding mechanism itself – as we will describe in chapter 3 – such that there is a clear calculation of the relative benefits of retaining tried and trusted favourites or renewing the schedule with fresh product.

- 8.5 Similar issues would arise in the secondary market, where UKTV's long-term contractual entitlement, at fixed rates, to BBC product has significant relevance to the growth and health of the broadcast industry. We are reluctant to advocate interference with legal contracts, but expect in due course that production units and their appointed distributors would recover freedom of manoeuvre. We also envisage that BBC TV Broadcast might secure full ownership of UKTV, such that it can more effectively manage rights negotiations in the domestic market.

9. The benefits

- 9.1 This process would expose great swathes of hidden cost sharing, which can either be properly allocated or eliminated. As a result, corporate objectives are likely to be scaled back, as corporate activity becomes more focused. This does not mean that the BBC need abandon its social purposes. As Channel 4 has shown, it is

possible to sustain high editorial and creative standards, as well as training investment, regional production, ethnic employment targets, and range and diversity of output, without making a single programme.

- 9.2 The “ethos” of BBC programme-making – freedom from direct commercial pressures and pursuit of quality for its own sake – could still survive these major changes, if BBC executives and commissioning editors so choose: it is the broadcast mind-set and budget that set the tone. Indeed, a crucial requirement of this process would be for BBC Broadcast to secure the commissioners, schedulers and managers who can thrive within this new set of relationships. We would expect them to welcome the clarity and focus the revised structure provides.
- 9.3 The value of the divested businesses would be large. In recent years, the sale or part-sale of companies such as talkback, Chrysalis and Hat Trick have involved sums in the tens of millions of pounds, and they represent a small fraction of the potential value of BBC Production. Similarly, with revenue in the hundreds of millions, BBC Worldwide could be sold for a substantial sum. We propose that the amounts raised from divestment be held by the BBC to be distributed in the manner we describe in Chapter 3.

9.4 We would expect the divested businesses to flourish. Organisations with social objectives are rarely the best “parents” for commercial ventures. The example of Crown Castle – the former BBC transmission business – shows how a change of parent, access to capital and freedom to expand can benefit a company.

9.5 In our view, these structural changes should dispose of many of the complaints of anti-competitive behaviour by the BBC from the private sector. This seems to us far better than a constant process of attrition between the BBC, its competitors and regulators, as would otherwise prevail, even with clearer rules and stronger enforcement. We further believe that the great majority of other complaints would fall away in the light of the changes to the way the BBC is financed that we propose in Chapter 3.

9.6 An additional benefit of these changes would be the enhancement of both plurality of voice and diversity of source.

established, even if the BBC Charter were renewed on the present terms, we believe that clarifying the BBC’s purpose, focusing the BBC’s activities and releasing the full flow of creative energies in UK production would be greatly to the benefit of the UK creative economy and the BBC itself.

10. Conclusion

10.1 Our recommendations on BBC structure are consistent with, but not dependent upon, the changes we propose in provision of public service broadcasting, BBC funding and BBC governance. Even if the licence fee were to be retained indefinitely, even if the Public Broadcasting Authority were not

Funding the BBC

The television licence fee should be steadily reduced from 2007 onwards, and gradually replaced by a combination of subscription and indirect public funding. It should be abolished completely when analogue television transmission is switched off.

1. The licence fee

- 1.1 In many eyes, the licence fee is the symbol of the BBC's integrity and independence, as well as its universal relevance. For the first 33 years of its life, the BBC was the only (legal) broadcaster. It was funded – uncontroversially – by the licence fee, and was required by its Charter to fulfil a variety of social purposes, so as to justify its unique access to publicly owned spectrum.
- 1.2 As television developed, the inherent weaknesses in the licence fee system became more apparent. A flat-rate charge for a dog licence or a vehicle licence was fair, because it was voluntary and directly connected to utilisation. But the television licence, often entirely unconnected to utilisation, is obligatory, requiring every TV household, however little BBC content it watches, to pay £121 per annum in advance (the BBC is

one of the few public organisations that penalises those who wish to pay as they go).

- 1.3 More significantly, even the very poorest homes regard television as a near necessity – as does the social welfare system, which will replace a broken TV, but incongruously will not pay the TV licence for those on benefits. As a result, every year many people are prosecuted for failure to pay the television licence fee. And every year, one or two are jailed when they cannot pay the fines imposed by courts.
- 1.4 The collection system costs the BBC well over £100m a year to operate. Despite the intensity with which evaders are pursued, 7% of homes dishonestly evade payment, so adding some £200m a year to the cost of the BBC for licence payers. The court costs involved in pursuing defaulters are not quantified, but must also run into the high tens of millions, none of which is borne by the BBC. No other organisation owed small sums is able to exploit the court system in this fashion: but then, gas, electricity and telephone companies can disconnect non-payers in a way not open at the moment to the BBC.

‘Our proposals are designed to increase, across our broadcasting system, the scope for the expression of free opinion and searching journalism. We propose replacing the licence fee with other sources of income, so removing much of the power of Government over the BBC.’

1.5 As the licence fee inexorably rises (it has never fallen), so as to allow the BBC to maintain and expand its array of services, the burden on the poor has become a growing political issue. Politicians have tried to reduce the scale of discontent by excluding identifiable groups – such as the oldest pensioners – from the obligation to pay.

1.6 This adds to the element of injustice and arbitrariness. Many elderly people, especially those with professional pensions, are much better able to pay the licence fee than single mothers on benefits. Indeed, the Institute for Public Policy Research recently advocated halving the cost of the licence fee for recipients of social security payments. Yet the immediate drawbacks of this proposal are clear: the cost of pursuing and prosecuting non-payers at the 50% level would double in relative terms; the licence fee would effectively become means-tested; and yet another disincentive to move from benefits to work would be created.

1.7 Critics of the licence fee, however vocal, have made little headway against the considerable level of

public and political support for the BBC. Yet the force of their critique is considerable: take Geoff Mulgan, currently one of the Government’s most senior policy advisers. The licence fee, he has said, is “probably the most regressive tax in Britain today. All other taxes are tied in some way either to income, wealth or spending. The licence fee alone stands as an inegalitarian flat-rate charge, linked in no way to ability to pay.” It offends, he goes on, “against basic principles of consumerism in that it is paid regardless of viewer opinions on the relative worth of channels”. It is a tax, he concludes, “which has no democratic component: it lends no choices to those who pay and conveys no information to the broadcaster”.

1.8 Gavyn Davies, the BBC’s former chairman, in his 1999 report on BBC financing, said that “the inherent disadvantages of the licence fee system imply that we should fund the minimum BBC services necessary to maintain a healthy broadcasting ecology in the UK, not the maximum amount that could be usefully spent”.

- 1.9 Defenders of the licence fee offer a mixture of pragmatic and principled responses. They point out that it has sustained the continued growth of an acclaimed British institution and offers excellent value for money. They defend it on the grounds of the benefits that universality delivers. They note that governments like the licence fee because it keeps a big lump of public spending off the Treasury's books. Above all they insist on its existence on the grounds of editorial independence. For these reasons they claim that there is no better alternative: it is, to put it no higher, the "least worst" option.

2. Editorial independence

- 2.1 We recognise the key significance of editorial freedom, together with conditions that promote freedom and willingness to exercise it. In this respect, the licence fee has limits and dangers. It is authorised by government and is the BBC's main source of income. Maintaining good relations with Government must, over time, be of paramount importance. Moreover, as we have tried to point out, now that the BBC, by virtue of its exclusive access to the licence fee, is by far the leading provider of public interest programming, it both bears huge responsibilities and a great burden of interest from governments intensely concerned with its influence. This puts it under constant pressure. We have recently seen the

damaging consequences of this. Greg Dyke is not the first Director General to be forced out after offending a Prime Minister.

- 2.2 In combination, our proposals are designed to increase, across our broadcasting system, the scope for the expression of free opinion and searching journalism. We propose replacing the licence fee with other sources of income, so removing much of the power of Government over the BBC. We propose market reforms which, aided by the digital revolution, will open up opportunities for new commercial and public service providers of insightful and forthright programmes addressing issues of public importance. We also propose to insert a statutory body, at arm's length from government, to see that the new structure delivers both pluralism and freedom of expression over a wide range of issues and viewpoints.

3. Value for money

- 3.1 The BBC makes its case that the licence fee offers value for money by claiming it allows economies of scale and scope and that its cost per hour of consumption compares favourably with, for instance, Sky. We do not accept this. There is no evidence that the scale and scope which the licence fee permits the BBC to generate deliver internal efficiencies rather than the power to exploit dominant market positions. As for the Sky comparison, the BBC is able to

spread its costs across 23 million forcibly acquired customers, as opposed to Sky's ten million volunteers.

- 3.2 Sky has to fight for its subscription revenue out of available consumer spending on entertainment after £2.7 billion a year has been removed from the pot and spent mostly on directly competing popular content. Sky has nonetheless been able to persuade nearly 40% of UK households to spend three times the licence fee on additional radio and television content. Yet Sky's low churn rate (little higher than the BBC's evasion rate) is some indication of consumer satisfaction.
- 3.3 The licence fee may have been reasonable – and good value for money – when there were only one or two channels. But with many other services available, and with some households watching BBC for three hours a week and others watching for thirty, value for money is a more questionable concept. The licence fee is now, in effect, a tax on TV set ownership, and no longer represents value of money relative to taxation since taxation would deliver the same value without collection costs and evasion.

4. Universality

- 4.1 One argument offered in support of the licence fee is the principle of universality: the availability, at no extra charge and without

encryption, of free-to-air broadcasts. These characteristics also apply to advertiser-funded channels, but the case for the licence fee is underpinned by the BBC's claim to have a unique relationship with the audience as a result of the special funding nexus. Some attribute a moral quality to the licence fee: immune to the pressures of advertisers and politicians, a licence-funded BBC can exclusively serve the viewer and listener. We accept that many people feel closer to the BBC than to other broadcasters because they know they pay for it.

- 4.2 Yet, as we have already noted, the requirement to serve all homes because all homes pay leads to paradoxical results as broadcasting competition intensifies. To sustain its income, the BBC needs to keep up its audience share. As a result, the audience is being charged for entertainment little different to that which the market supplies on a more rational funding basis.
- 4.3 In any event, the BBC has effectively abandoned universality, by financing its new digital services out of the licence fee, even though they can only be seen by the 50% of licence fee payers who have installed the necessary equipment.
- 4.4 It is true that the BBC originally endorsed the principle advocated by the Davies Panel by which any new BBC digital services should be paid for by those who could gain access to them. However, when

other digital broadcasters objected to what they saw as a tax on digital equipment, Downing Street reportedly over-ruled Davies and decreed that the licence fee should be increased to cover the costs of the new services.

- 4.5 The main objector – ITV Digital – has since been liquidated, but the BBC has declined to return to the Davies principle, even though Mr Davies subsequently became the BBC's Chairman. It is clear that, currently, the only real meaning of universality in connection with the licence fee is in universality of payment, rather than of access.

5. A JP's view

- 5.1 One JP from Slough, Ms Joan Horton, was so infuriated by the situation that she was moved to write to The Times at the end of 2003. It is worth studying her comments in detail.
- 5.2 "As a JP, I have for 20 years had the difficult task of sentencing TV licence defaulters, followed some months later by the often hopeless task of fine enforcement. Unlike other offenders, TV licence evaders are predominantly female, many of them benefit recipients with children. The majority are single, struggling to keep their families financially afloat. Food and electricity tokens often take priority over a weekly TV licence payment.

- 5.3 "If still without a licence, offenders can be re-prosecuted almost immediately unless they dispose of their TVs. Repeat offences generally attract a higher penalty than a first offence. (NB: The Citizens Advice Bureau reports that the BBC's collection agency pursues known offenders as the easiest to target.)

- 5.4 "Last week in the fine default court I adjudicated on just such a case. A woman had had two licence evasion fines plus costs imposed within a short period. Her income, rent arrears, and general circumstances meant that there was no hope of extracting the whole sum. A bailiff's visit had been unproductive as she had no assets worth taking. We had to remit a large portion of the combined fines and costs, so as to leave a more manageable sum that would take a year to clear at £2 a week. What a waste of public money and court resources.

- 5.5 "Surely this system is a nonsense. Other than to collect the fee, there is no public interest need for TV set owners to be centrally registered. Licence fees cost millions each year to collect, plus further huge sums from the taxpayer for fine enforcement. A concessional rate for the poor will create extra costs disproportionate to the reduced sums collected. It will cause confusion, and many entitled people will fail to claim. There is also an inequity in consumers

being forced to pay for one service, before being permitted to use any of its many competitors.

- 5.6 “The BBC is a public service. As such, it could receive a grant directly from the Exchequer, with its editorial independence guaranteed by statute. With the millions saved on collection and enforcement, the compensating adjustment to income tax would be tiny, with most households breaking even. Vitally, thousands of low-income households would be relieved of an onerous burden. The forgetful and disorganised would not be criminalised. Hundreds of hours of court time currently spent on TV licence cases could be freed to reduce the oft-complained-of delay in hearing trials.”

6. Funding by the Treasury

- 6.1 If the options for funding the BBC were limited to the licence fee or general taxation, we would want to pursue the taxation argument. The reason that we do not is that we believe the licence fee itself to be in the last stages of its long life.
- 6.2 The attractions of switching to tax funding are considerable: decriminalising a civil debt, unblocking the courts, relieving a burden on many poorer homes, and eliminating hundreds of millions of pounds a year of unnecessary collection and enforcement costs. Moreover, insofar as the primary purpose of

central funding might be the provision of merit good content, there is a strong case for this to be provided out of taxation, as are other merit goods, such as health, education, culture and defence.

- 6.3 The biggest difficulty with the licence fee in relation to tax funding, as we discussed in Chapter 1, is that it increasingly funds entertainment rather than public service content. When Gavyn Davies chaired his 1999 panel, tasked with deciding how to fund the BBC’s digital ambitions, his words were salutary: “To support the continued existence of the BBC as the recipient of a universal compulsory charge, we need to believe that a large share of the Corporation’s output falls into the public service category”. Anyone monitoring the schedules of BBC1 – which absorbs a larger proportion of the licence fee than all other BBC services combined – would be hard pressed to sustain that belief.

7. Advertising

- 7.1 What are the other alternatives to the licence fee? Reliance solely on advertising would, it is claimed, put the BBC at risk, undermine the revenues of ITV and most other commercial broadcasters, and place most of British broadcasting in direct competition for the same source of funding: altogether an undesirable state of affairs.

- 7.2 Supporters of advertising funding for the BBC – which, according to surveys, includes a majority of the public – emphasise the option of part-funding through advertising, rather than sole funding, thereby limiting collateral damage.

However, if the licence fee were fixed, but the BBC was free to pursue as much advertising revenue as it could raise, the pressure to popularise its output would strengthen. Conversely, if the licence fee were not fixed, the pressure, from those who pay it, on the BBC to increase its advertising revenue so as to reduce the licence fee would have the same effect.

- 7.3 Public opinion surveys show a relatively low level of support for the licence fee and rather more for the BBC to be financed by advertising. However, they become more ambiguous when possible consequences (narrowing of choice, loss of many merit good programmes and editorial independence) are spelled out. Our own view is that, as long as any BBC services are funded in whole or primarily by the licence fee or the PBA, there is a case for them not to be allowed to take advertisements because the BBC will still enjoy the benefit of an intervention largely denied to its competitors.

- 7.4 This is also partly based on the fact that some consumers dislike commercial breaks and wish to protect themselves and their

families from them: (though we note that other consumers are equally irritated by the large number of BBC promotions that instead act as buffers between programmes). A further factor is that BBC channels with access to substantial amounts of public funding would risk legal challenge under EU rules if they also dipped their fingers in the advertising pot.

- 7.5 However, should (as we recommend) the licence fee be abolished, different considerations in relation to advertising would apply. After all, the UKTV joint venture already takes advertisements as well as subscriptions, and there is no reason why the BBC's wholly owned digital services, once they are fully commercial, should not be entitled to augment their subscription revenues with advertising, as do their competitors.

8. Subscription

- 8.1 Our view is that, except for merit good output, which should be paid for out of taxation, voluntary subscription is the most equitable and efficient way of responding to consumer preferences and funding the BBC. This is, we note, the conclusion the Peacock Report arrived at 18 years ago, long before there was any real prospect of installing the equipment in homes that would make such a system possible. Today, however, nearly 50% of homes already have such equipment, and government

- policy is to hasten the moment when that figure approaches 100%.
- 8.2 At the time of Peacock, the BBC was very interested in the subscription option, at least in theory. Since then, it has rejected the idea, presumably in the belief that it carries more risk than the licence fee system, but ostensibly on the basis that it reduces consumer welfare and undermines the BBC's cardinal principle of universality. We believe that subscription, with its flexibility and fairer impact on multi-set homes, increases consumer welfare in comparison with the licence fee because consumers pay to view what they want.
- 8.3 It is not easy to predict what proportion of homes would decline to take the BBC on a voluntary subscription basis, especially when well funded, free-to-air universal services such as ITV and Channel 4 are available. In our own modelling, we have assumed 20% or more will not subscribe to the BBC. This no reflection on the potential quality of the BBC's services but rather a general view that the ability to choose rather than the obligation to pay would reduce uptake. BBC costs or prices would need to adjust to reflect this.
- 8.4 However, subscription funding will not pay for all of the services and programmes that the BBC currently funds from the licence fee. Provision needs to be made for these during the transition to analogue switch-off when universal digital subscription will be possible and the licence fee will cease to exist. First, we believe that BBC Radio should be operated independently, with its income sourced – subject to the proposals of the PBA – from tax revenues (offset by the continuing licence fee) allocated to public service broadcasting. Secondly, BBC Television's own public service content should be underwritten by those revenues, on the same basis as long as the licence fee lasts. Thirdly, during a period of transition from analogue to digital, a proportion of BBC Television's entertainment costs can also legitimately be borne by those revenues.
- 8.5 Only after analogue transmissions cease, and the BBC converts fully to digital and subscription, will the BBC's judgement as to how attractive its entertainment is in a competitive market be put fully to the test. Our expectation is that the BBC will handle this situation with great skill and professionalism.
- 8.6 Some may worry that the viewing public will suffer as a result: but there are two reasons why we do not share that worry. The first is that we expect the amount of public interest content to be maintained, though delivered through a more varied supply chain. The second is that we expect the BBC to continue providing a steady flow of

entertainment, but through a different funding mechanism. Viewers will not lose content: but they will gain choice. As a stimulus to digital take-up, the BBC digital offering will increase in appeal relative to the free-to-air offering on analogue (which, in fairness, will itself reduce in cost): any viewer keen to enjoy the BBC's subscription services need only upgrade to digital and pay the BBC directly for its full package.

9. Analogue switch-off

- 9.1 Recently, there have been indications that the government is rethinking its approach to analogue switch-off. Currently, the official line is that switch-off is intended to take place between 2006 and 2010, provided that 95% of homes have taken up digital television, that the digital signal is available to 99% of the population and that the price of digital equipment is affordable.
- 9.2 The digital signal has always been available (by satellite) to 99% of homes. Affordability is a matter of opinion, but for a one-off price of about £100, anyone can connect to a range of free-to-air digital channels, including the main five and all the BBC digital services. The critical outstanding issue has been the 95% take-up target.
- 9.3 Hiding behind that figure has been the uncomfortable fact that the average home has four items of viewing equipment – usually, three

televisions and a video recorder. Nearly all of them are currently dependent on analogue signals. Even if 95% of homes install one digital device (the present figure is 50%) this would still leave three-quarters of the nation's stock of equipment to be upgraded. Most analysts have concluded that it is simply impossible to reach a true figure of 95% take-up in relation to all relevant equipment in the published time-scale, and that the cost of proceeding with switch-off prematurely – before consumers have substantially adopted digital technology voluntarily – would be prohibitive.

- 9.4 Although the BBC (with Crown Castle, the transmission company, and BSkyB) has taken control of the digital terrestrial television (DTT) platform since the collapse of ITV Digital, limitations on the frequencies and power that can be used mean that 25% of household rooftop aerials and the great majority of portable televisions cannot pick up the DTT signal.
- 9.5 Very heavy marketing of DTT through the Freeview package has produced encouraging results, but even if 1million Freeview boxes were installed every year for some years (which published analysts' research has doubted), they would make barely a dent in the 95 million unit analogue equipment mountain, which itself is growing at 8 million units a year.

- 9.6 For the BBC, a very lengthy delay in achieving switch-off would cause major constitutional problems in relation to the way its new digital channels were funded. The BBC justifies its breach of the universality rule, which forces all licence payers to fund digital services which half of them cannot see, on the basis that it is temporary. Moreover, all terrestrial broadcasters, having committed to the cost of DTT transmissions on the assumption of early analogue switch-off, are dismayed by the prospect of an open-ended payment for dual transmission, costing some £100 million per annum. There has been an intense effort to find an alternative, faster route, especially as older analogue transmitters come up for renewal or replacement.
- 9.7 The new approach involves dropping the 95% figure, and simply replacing specific analogue transmissions with digital services overnight. This “big bang” approach removes the problem of aerials and portable sets, because it uses existing frequencies and power levels. The working assumption is that, (moving steadily through the UK, transmitter area by transmitter area), BBC2 will be switched off first, to be replaced by all the BBC digital services (including BBC1 and BBC2). The BBC is not, as yet, publicly committed to this: but it is the only broadcaster for which the risks involved do not immediately affect its revenues.
- 9.8 On the premise that nearly all households in a given area, either before the first switch-off or soon after, have acquired the necessary digital equipment, BBC1 can be switched off next, and its place taken by the main commercial services, notably ITV and Channel 4. In due course, a third analogue signal (ITV or Channel 4, presumably) can be switched off, to make way for other digital channels, and eventually the whole analogue system in a particular area can be closed.
- 9.9 This ambitious plan is risky. It involves daunting problems of execution, public relations, and political will. Those who recall the last time anything similar was attempted – the switch from 405-line transmission to 625-line – will remember how long it took (21 years) to achieve something vastly simpler than analogue switch-off, and how unwilling ministers were to alienate voters (just 15,000 homes dependent on 405-lines remained when the last transmitters were turned off). All video recorders will lose key functionality unless they are individually upgraded or replaced with digital machines. It will be a bold government that reveals such a plan immediately before an election (which may put paid to hopes of a 2004 announcement), and a foolish one that imagines the whole process could be completed between elections.

10. The end-game

- 10.1 One noteworthy aspect of the revised analogue switch-off proposal is the suggestion that the BBC absorbs viewing lost in the changeover, as multi-set homes find themselves without first BBC2 and then BBC1, except on upgraded sets. More importantly, the new equipment required to view BBC channels after switch-off opens up a means, at long last, of implementing the 1986 Peacock proposal for subscription-based BBC services.
- 10.2 All cable and satellite installations require set-top boxes that contain conditional access (CA) modules, controlling the viewer's ability to see each channel or bouquet of channels, subject to appropriate payment. DTT set-top boxes do not all contain a CA module, partly as a result of the emphasis in Freeview marketing on free-to-air viewing. However, the cost of including one in future boxes is minimal, and upgrading the existing population of non-CA boxes a relatively straightforward exercise.
- 10.3 Our first recommendation on funding is that, within two years, all DTT boxes contain a conditional access module. This will ease the transfer to future financing of the BBC by subscription. Our belief is that, in due course, Freeview will transmute into a form of Freeview Plus, with some basic tier pay channels added to the line-up to increase the appeal of DTT. If it does not, then CA modules may need to become mandatory: this is no hardship for manufacturers or consumers, as hardware costs are barely affected, and viewers can still see free-to-air channels without any payment.
- 10.4 Our second recommendation is that all BBC digital services be encrypted, except those (like, perhaps, BBC Parliament) that the PBA chooses to fund, soon after 2006. Households wishing to continue to view these channels would be required to pay the subscriptions necessary to provide them. The licence fee could be reduced in step with the build-up of revenue from subscriptions.
- 10.5 This is eminently fair. It is what the Davies Panel intended and the BBC accepted in 1999. However, we oppose any attempt to make payment for the BBC digital channels compulsory for all digital households. We are not proposing a general digital licence fee (as Davies described it) but a subscription for BBC channels. Some households currently receiving these channels may choose to do without them. After all, there is no means of forcing people to watch BBC content, so there can be no justification in forcing them to subsidise what others want to watch and are willing to buy. If so, non-subscriber viewing costs will decline since the licence fee will be reducing. Those who choose to subscribe will pay

the licence fee (as long as it continues to exist) as well as the digital subscription fee. The BBC will be able to set its own prices according to the marketing strategy it chooses to drive subscription take-up.

- 10.6 Our recommendation is that the licence fee should be reduced not just in proportion to the compensating revenue from the take-up of digital subscription but beyond that level as well. Reducing the licence fee further removes the pressure on the BBC to win audience share on analogue channels. Concomitantly, the need to drive ratings on analogue channels by funding first-run entertainment content from this source will diminish.
- 10.7 Another virtue of a subscription system is that it will apply to each set, rather than to each home, so distributing the cost of content more fairly between multi-set homes and single-set homes. In addition, in so far as it makes evasion impossible, the 7% of licence evaders will be excluded, which is fairer for the honest 93%.
- 10.8 During transition, we fully expect the amount of entertainment available to be maintained, as other broadcasters respond to the changed environment, and as the BBC itself comes to terms with its two funding sources. We anticipate that the BBC will swiftly reinforce the subscription-funded channels with first-run entertainment and

the most popular programmes may well regularly receive their first transmission on digital subscription channels (which would drive take-up and therefore subscription revenue), with the licence-funded analogue services taking second runs.

- 10.9 The process of analogue switch-off will allow the BBC to transfer fully to subscription funding. Once BBC television services can only be accessed through a set-top box or digital receiver it can then switch to electronic collection of fees, rather than maintain an army of detector vans and collection agents, buttressed by criminal prosecutions. At last, the BBC will be in the same position as gas, electricity or telephone companies, able to cut off supplies to non-payers. For the poor or those with little interest in paying for television, new commercial digital free-to-air services will no doubt emerge, playing repeats or second-runs, supplemented by unencrypted programmes funded by the PBA or advertising. Regulatory oversight would be alerted if sectors of the population were losing access to quality programming on a scale that caused concern, and steps would be taken to remedy that using the machinery we have proposed.

11. The benefits of subscription

- 11.1 We believe that subscription will make the BBC more accountable (to its customers), more

transparent in its finances (especially if the structural changes in Chapter 2 are adopted), more independent of politicians (who will lose the power to determine its income), more flexible (in being able to offer different channel packages at different prices) and more efficient (especially if Ofcom regulates its pricing to ensure that it does not abuse what is likely to be a dominant position in the pay-TV market).

11.2 If the revised plan for analogue switch-off is successfully pursued, the BBC will become fully digital by 2011 or 2012. The licence fee can be abolished at that point. There may well be a case for the licence fee to be cancelled region by region before then, as switch-off proceeds, if this does not create unduly complex administrative problems. The prospect of faster abolition might alleviate some of the public relations problems associated with a process likely to cause major disruption and discontent.

11.3 We have a further proposal to assist the transition process. We expect the proceeds from the divestment of BBC Production and Worldwide to raise a very substantial sum. We recommend that, over a five-year period after 2006, every one who pays a licence fee or BBC subscription should receive a proportional credit, which will entitle them to a share of the divestment proceeds in about 2011. That one-off dividend from

divestment should assist in maintaining revenue flows during the transition.

11.4 Even if the switch-off timetable slips, or if the revised strategy proves too problematic, we believe that the BBC could fully transfer to subscription ahead of analogue switch-off, at the point where first-set digital take-up reaches 95% (again, this may be deliverable regionally). The BBC is already in the front line for this role in the revised switch-off plan. If the BBC transfers voluntarily to all-digital transmission and to subscription funding, it will make a considerable difference to the switch-off process.

11.5 We recommend that the BBC and the government plan for a conversion of the BBC fully to subscription funding at or before analogue switch-off, and no later than when there is 95% first-set digital penetration. As take-up will be closely monitored, there should be ample time for the BBC to put in place the necessary procedures.

11.6 Taken together, our funding proposals for public interest content and the BBC should allow the licence fee to be reduced to about £100 in 2006, and between £50 and £70 by the time it is abolished, depending on cost-benefit analysis by the Treasury and the DCMS in relation to the revenues generated, the cost of collecting them, and their contribution to the funding needs of the PBA.

11.7 As we recommend in Chapter 1, the BBC should hand over responsibility for setting, collecting and managing the licence fee from 2006. The reducing fee will allow for smoothing of the transition to funding all public interest content and a proportion of BBC entertainment output from the Exchequer grant to the PBA. The BBC's proposals, in terms of entertainment and public interest content, will be assessed by the PBA. Separately, the Treasury may well conclude at some point in the process that the collection costs and other disadvantages of the licence system become disproportionate as the net revenue declines, and decide to phase it out.

11.8 Once the BBC is funded by voluntary subscription, its obligations should be entirely to its subscribers. It will cease to have any particular privileges (other than its superior DTT frequencies, for which it will in due course have to pay market prices); there is therefore no reason to impose any particular obligations other than the broadcast codes and competition rules that govern all broadcasters.

11.9 The licence fee can be finally laid to rest at the point where the BBC ceases analogue transmissions and transfers fully to subscription funding. As this is planned to happen well within the decade after 2006, this is an additional reason for recommending, as

we do in the next chapter, that the current Charter be the last such document.

Governance, Regulation, Accountability

The era of Charters and Governors should end. In future, the BBC should be regulated by consumer power, creative and commercial competition and a new institutional structure.

1. Background

- 1.1 Although the British Broadcasting Company began life in 1922 as a private business, there were immediate concerns that its activities would require public oversight. There was anxiety that signals might interfere with each other. Newspapers did not wish to see a competitor for advertising emerge. There was a national security dimension. There was also a feeling that broadcasting ought to have a public purpose. In a book published in 1924, the BBC's first head, John Reith, argued that making money should not be the purpose of broadcasting. Instead, broadcasting should "carry into the greatest possible number of homes everything that is best in every department of human knowledge, endeavour or achievement."
- 1.2 There was dissatisfaction at the time with the workings of the free market, and a widespread belief that public officials ought to produce sounder results than capitalism. The first world war had helped establish a culture of central control. On the other hand, political parties opposed direct control of broadcasting by the government, because they feared this would put them at a disadvantage when they were in opposition. Water and electricity were already run by public corporations. The economist Lincoln Gordon noted that by the 1920s "public boards have become all the rage".
- 1.3 In 1925, the government set up a committee of inquiry under the Earl of Crawford into the governance of the BBC. In a key piece of evidence, Evelyn Murray, the Secretary of the Post Office, proposed a public corporation with a representative governing body which would remain politically independent of the government. In 1926, the Crawford Committee recommended that broadcasting in Britain should be a monopolistic, non-profit operation supervised by a commission of persons of "judgement and independence" acting as "trustees of the national interest".

‘For the BBC, accountability would be achieved through a combination of consumer sovereignty and creative and commercial competition, backed up by sound, transparent institutional machinery.’

1.4 In July 1926, the government announced that the British Broadcasting Corporation would come into existence on 1 January 1927, and would derive its authority from a Royal Charter. In essence, this system of governance has remained unaltered through successive Charter renewals. The BBC is overseen by a board of 12 Governors appointed by the Crown for a five-year renewable term. All are part-time, generally having experience in public service or the arts, business or industry. The board includes national Governors for Scotland, Wales and Northern Ireland. There is also a Governor for the English regions.

1.5 The Governors are instructed to ensure that the BBC is directed and managed in the public interest and accountable to licence-payers and Parliament; that it complies with its Charter, Agreement with the Treasury and other regulations; that it complies with the law; and that it maintains high standards and the values appropriate for a national broadcaster.

2. Changing attitudes

2.1 Though the thinking behind the

establishment of the Corporation reflected the mood of the times, very different attitudes have now taken root. The elite have lost both the trust and respect which they used to enjoy. Accountability, democracy and transparency have come to be expected in the exercise of public business. Against this background, the arrangements by which the BBC is run look increasingly out of place.

2.2 Almost uniquely in our society, the BBC is a public institution accountable for much of what it does only to itself. The BBC has some of the characteristics of a government department without the Parliamentary accountability taken for granted in the exercise of governmental functions. Once appointed, the BBC's Board of Governors are expected to combine the tasks of controlling the Corporation and at the same time regulating it.

2.3. Being a law unto itself has left the BBC open to allegations of arrogance, and even of contempt for those who challenge its decisions. Whatever the justice of such complaints, they cannot easily be disposed of as long as the

institutional apparatus engenders a culture of immunity.

3. Failings of the current system

- 3.1 Many of those who work in the BBC, preside over it and support it maintain that its system of governance should continue unchanged. Indeed, they maintain it is essential that it does so. In an interview in the Financial Times in January 2004, the former Chairman of the Governors, Gavyn Davies, defended the present system as follows: "I think it's the only model which guarantees independence for the BBC from commercial and political and competitive pressure." The defence of the current governance arrangements has always been that they are necessary to protect the independence which has been so highly valued a feature of the Corporation throughout its life.
- 3.2 The BBC of course maintains that its Governors can operate successfully as both its regulators and cheerleaders. Under any circumstances this would be a difficult task, yet the Governors are not chosen solely for their ability to perform it, but partly to represent geographical and other interests. They often have demanding day jobs, and may have no previous experience of the workings of the broadcasting industry. Assembling normally just once a month to hear the management explain what should be done, they are hardly in much of a position to argue.

3.3 Their Chairman, on the other hand, has become more and more of an executive figure, with an office at Broadcasting House and regular and frequent contact with the Corporation's top managers. Mr Davies told the Financial Times: "I am pretty much full-time and I sit in the building more or less all the time." This trend towards executive chairmanship has however had the effect of changing the chairman from being the chief guardian of the public interest into the BBC's chief cheerleader. The Governors themselves can appear merely to be rubber-stamping the corporate line.

3.4 This situation was highlighted by the crisis at the end of January 2004 precipitated by the Hutton Report, which led to the resignations of both the Chairman and the Director General. In July 2003, the Governors had met to consider a Government complaint about the Corporation's reporting. The Governors issued a statement in support of the BBC's journalism without first conducting an inquiry into the facts of the matter. Lord Hutton's inquiry revealed evidence unknown to the Governors which might have called for a different determination.

4. The reform agenda

- 4.1 There is now widespread acceptance that the BBC's governance arrangements will have to change. Indeed, some

regulatory functions have already been transferred to Ofcom. The government has taken upon itself responsibility for approving new BBC services.

- 4.2 The further step most often canvassed is the transfer of the Governors' remaining regulatory functions to Ofcom. This would ensure regulation by a separate body suitably distant from the BBC itself. Nonetheless, there are reasons for doubting whether this change would sufficiently address the scale of the problem. Regulators, even independent regulators, face real difficulties in attempting to shape the behaviour of creative institutions.

5. A new Corporation

- 5.1 Our group came to the conclusion that the very idea of incorporation under Royal Charter, with its suggestions of privilege and unaccountability, was out of step with the attitudes prevailing in the 21st century. When hereditary peers and the Lord Chancellor are being abolished, it is hard to see why a public broadcaster should continue to stand outside the normal arrangements which now govern the life of the nation elsewhere.
- 5.2 We therefore propose that the BBC's current Royal Charter, which expires on 31 December 2006, should not be renewed. Instead an entirely new Corporation structured along conventional

corporate lines should replace it, with shares to be owned by government. A comparable model for such ownership arrangements for a publicly owned broadcaster already exists at Channel 4.

The Channel 4 experience has demonstrated that such a system of governance could be expected to operate effectively and transparently.

- 5.3 The new Corporation would take over all of the functions of its predecessor, except self-regulation (see 7.1 below). In 2007, this would mean running the radio, television and internet broadcasting operations and the present Corporation's production and distribution activities. The Corporation would retain responsibility for both domestic and overseas radio broadcasting for the foreseeable future. Funding for the latter would continue to come through a Foreign Office grant rather than from the Public Broadcasting Authority, since we see no reason to amend a system which appears to work satisfactorily. However, the Corporation would gradually relinquish control of those activities which we believe should be divested (see Chapter 2).
- 5.4 Implementing the divestment programme would be one of the most demanding tasks which the new board would face. It would require skills and experience quite different from those of successive boards of Governors. A new body

tasked from the outset to address this new challenge as a priority would be likely to make a better job of it than another Board of Governors. We note the energy and ambition which has been brought to the regulation of this sector by the creation of Ofcom.

- 5.5 A number of benefits would flow from this change. The whole process of Charter review at ten-yearly intervals, and the uncertainty it brings with it, would disappear. The political threat to the Corporation's independence implicit in the prospect of Charter review would also go.

6. Composition of the Corporation

- 6.1 The Corporation would have a mixed board of executives and non-executives, the non-executives, whose functions would be the same as those of non-executive directors of public companies, would be appointed by Ofcom.
- 6.6 Comparisons could readily be made between the workings of the new BBC and other public corporations. It would thus be easier to spot deviations from best practice as identified in both the domestic and international arenas.

7. A regulatory framework

- 7.1 Although the reformed BBC would be constituted on a sounder basis than the existing Corporation, that does not mean that it could or

should be entrusted with the regulation of its own activities. We believe that a healthy institution should be subjected to the operation of a healthy regulatory regime, and we think several different elements could combine to provide this.

- 7.2 From the outset, the new Corporation would of course be subject to regulation by Ofcom under Tiers 1 and 2 of the regulatory machinery provided by the Communications Act. This already covers matters such as sponsorship rules, compliance with international obligations, promotion of equal opportunities, training, provision of subtitling and sign language, independent production quotas, original and regional production quotas, news output and much else. There would remain the issue of strategic direction.
- 7.3 This should be less of an issue once a system of contestable funding were in place, as the new system would introduce an element of competition which would in itself motivate the BBC, like other broadcasters, to try harder in the field of public service programming (see Chapter 1). The divestment of some activities (see Chapter 2) should also introduce positive competitive pressures and diminish concerns about potential threats to pluralism. Nonetheless, there would still be a residual requirement to ensure that the Corporation fulfilled its public

remit in return for the public privileges which it would still enjoy. The task of achieving this could be shared between Ofcom and the Public Broadcasting Authority (see Chapter 1).

8. Twin external regulators

- 8.1 Ofcom is already charged with assessing the delivery of public service content across the whole of British broadcasting. This will involve making a judgement on the effectiveness of the BBC's public service output. Ensuring that any deficiencies identified by Ofcom are remedied is a role that would fall naturally to the Public Broadcasting Authority (see Chapter 1). The PBA would control the disbursement of all public funding to the BBC for its public service output, and for its entertainment output on television until the divestment of television broadcasting, and on domestic radio services indefinitely. Insofar as the PBA considered that the Corporation had defaulted on its obligations, it could require changes of policy or redeploy to rival broadcasters funding which might otherwise have gone to the BBC.

9. Transition

- 9.1 Particular regulatory issues would arise between 2006 and the point at which BBC television broadcasting became a business relying primarily on subscription income. During this period, the

Corporation would be responsible for providing both public service and entertainment services on its analogue frequencies at the same time as it was transferring first runs of premium output to digital channels accessible only to subscribers (see Chapter 3).

- 9.2 During this time there would be a continuing need for public funding of the Corporation's entertainment output on television beyond that which subscription income was covering. A licence fee would need to persist during these years, albeit at a lower and declining level, so that other taxes would not have to be raised to provide the public money which the Public Broadcasting Authority would require to fund the BBC.
- 9.3 It would be up to the PBA and Ofcom to ensure that the quality of the entertainment available on the BBC's analogue frequencies was not degraded in a way which would be unfair to licence-payers who had yet to go digital. Though first runs of prime assets would be transferred to subscription digital services during this period of dual funding, people who were still paying a licence fee but declining to switch to digital reception should not be unduly disadvantaged. Entertainment content that had transferred from free-to-air analogue to subscription digital would need to be made available within a reasonable period to the free-to-air services.

10. Divested assets

10.1 Those existing BBC operations which would be divested from 2007 onwards would be subject to the same regulatory regime as their commercial rivals. Management would be responsible to the shareholders for financial performance. The companies involved would be subject to the control of Ofcom, the Office of Fair Trading and all the ordinances that govern activity within the broadcasting sector. No special arrangements would apply to ex-BBC entities.

10.2 This would mean that the principal regulator of what had been BBC television broadcasting would become consumer power, perhaps the most effective regulatory force humanity has so far discovered. When selling its output in the pay-TV marketplace, the BBC would automatically be making itself accountable to its customers, who could express dissatisfaction by canceling their subscriptions. There is every reason to suppose that this would be a highly effective mechanism for maintaining standards.

confident that these arrangements would guarantee the health of our national broadcaster, beyond the Charter.

11. Conclusion

11.1 For the BBC, accountability would thus be achieved through a combination of consumer sovereignty and creative and commercial competition, backed up by sound, transparent institutional machinery. We are

Summary and Recommendations

Summary

Rapid changes in technology and funding have exposed underlying faults in our present broadcasting system. The way in which the BBC is financed, governed and structured needs radical reform. So too does the system of delivering socially valuable programming which the market is unlikely to generate: the essence of what we call public service broadcasting.

The steady take-up of digital television technology, in widening channel choice and increasing audience fragmentation, is putting increasing strain on the delivery of public service content through the main terrestrial channels.

The commercial television channels (ITV and five) have too little incentive to include high-quality public service content prominently in their schedules. The non-profit channels (BBC and Channel 4) continue to provide significant volumes of such content, but with reducing prominence, frequency and – some argue – quality.

The licence fee should in theory liberate the BBC to concentrate on public service content, but the need to protect it by maintaining audience share across media provides a contrary pressure. Channel 4 has warned that its weakening audience

performance and funding base is eroding its ability to fulfil its remit.

The direct cost (through the licence fee) and indirect cost (through discounted or foregone spectrum payments) of public service broadcasting continues to rise, with diminishing returns. As the funding gap between the BBC and its advertiser-funded rivals widens, the increasing dominance of public service delivery by the BBC endangers pluralism, as does the BBC's position as the biggest of all cross-media owners.

Public funding of public service content should be future-proofed, transparent, ring-fenced, based on evident need and demonstrably good value for money. To ensure consistency of delivery and diversity of sourcing, it needs a strong champion and a secure base outside any particular broadcast institution.

The BBC should use the rapid take-up of digital technology to transfer its primary source of funding from a compulsory, flat-rate licence fee to a voluntary and more flexible combination of subscription and, perhaps at some point, advertising. This will align it with government policy on analogue switch-off. The licence fee can be progressively reduced from 2007 until its abolition at switch-off, without the BBC being disadvantaged.

'Public funding of public service content should be future-proofed, transparent, ring-fenced, based on evident need and demonstrably good value for money.'

The BBC should also be progressively re-structured so as to allow the broadcasting industry's creative energies to flow more freely. Most of the current objections to the BBC's behaviour from competitors would fall away if BBC Television Broadcast division was not attached to an in-house production department or distribution arm. The resources within BBC Television Production should be released for the benefit of the creative community as a whole.

BBC governance needs to adjust to this logic. A new corporate structure should be created, still in public ownership, but with the freedom to release various parts of the BBC into private ownership after 2006. BBC Radio should be publicly funded and publicly owned for the foreseeable future.

Recommendations

- 1) After 2006, the BBC should become a public corporation in the same fashion as Channel 4, with all its shares owned by the Government, and its chairman and non-executive directors appointed by Ofcom.
- 2) The new version of the BBC should have a combined board of executive and non-executive members, and be regulated, where relevant, by Ofcom,

whilst accounting annually to Parliament.

- 3) Most of the BBC's digital channels should cease to be publicly funded from 2007: those that require public funding, such as BBC Parliament, should continue to receive it, whilst all others should be funded by voluntary subscription, and possibly advertising.
- 4) By 2006, all new digital set-top boxes should be equipped with conditional access technology.
- 5) The licence fee should be reduced starting in 2007, and should continue to decline until its abolition, with responsibility for collecting and receiving it transferred to the Treasury.
- 6) From 2007, ITV and five should be released from all positive content obligations, and should be required instead to pay the full value of the spectrum they occupy, like all other broadcasters.
- 7) From 2007, a new body, the Public Broadcasting Authority (PBA), accountable to Ofcom, should take responsibility for delivery of all public service content.

- 8) The PBA should be funded directly by the Treasury, on a rolling five-year basis, at the level required to meet the need for and cost of socially valuable content that would not otherwise be funded by the market.
- 9) All broadcasters should be entitled to bid for PBA funding, with producers also able to submit projects, so long as they have secured suitable broadcast arrangements.
- 10) The PBA should make funding available for public service content on television, radio, the internet and mobile telephones.
- 11) Until analogue switch-off, the PBA should allocate a significant proportion of its funds to supporting transmissions on BBC analogue services.
- 12) These transmissions should include entertainment, much as they currently do, but at a declining cost, as the BBC transfers increasing volumes of first-run entertainment television to its commercially funded channels.
- 13) Analogue switch-off, or 95 per cent first-set, digital take-up, should be the trigger for BBC Television to transfer fully to subscription, possibly supplemented by advertising, and with the option to seek PBA funding: the licence fee could then be abolished.
- 14) In television, BBC Production should be divested from BBC Broadcast, so as to open up the full extent of the BBC schedules to competitive supply, as well as allowing the creative talent housed in BBC Production to serve the broadcast industry as a whole.
- 15) BBC Commercial Holdings, including the distribution function in BBC Worldwide, should also be divested, so as to ensure that any remaining tendency to distort terms of trade is removed.
- 16) All divestment proceeds should be returned to licence fee payers.
- 17) At the point when analogue television transmissions cease, and BBC Broadcast moves all its television services to commercial funding, there should be a full separation of television and radio.
- 18) BBC Radio should continue to be publicly owned, but there is no reason why the television broadcast services need to be: privatisation is one obvious option.
- 19) Channel 4 should remain in public ownership, using its unique financial structure to support a specific remit: like other broadcasters, it should be able to apply to the PBA for additional funding.

The Authors

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Chairman



David Elstein has held senior editorial positions at the BBC, LWT, Primetime Television and Thames

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also a main board Director and Director of Programmes. His production experience encompasses major current affairs programmes such as *This Week* and *A Week in Politics*. He was Head of Programming at BSkyB from 1993 to 1996. In 1996, he became the Chief Executive of Channel 5. He now divides his time between non-executive directorships, pro-bono appointments and consulting work. His current appointments include: Chairman, Really Useful Theatres Ltd; Chairman, Screen Digest Ltd; Chairman, British Screen Advisory Council; Non-executive Director, ntl Inc; Visiting Professor, Westminster University and Stirling University.

David Cox



David Cox is a television producer who makes current affairs and history programmes. He also writes on broadcasting for the

New Statesman. From 1970 to 1973 he was a newspaper journalist, working for the *Luton Evening Post* and then *The Sunday Times* and the *Daily Mail*. He joined *London Weekend Television* in 1973 to work on the ITV current affairs programme *Weekend World*. In 1977 he became the editor of this programme, a post he held for five years. From 1982 until 1987 he was Head of Current Affairs at LWT. Since then, he has made programmes for ITV, the BBC and Channel 4.

Barbara Donoghue



Barbara Donoghue is a senior banker with twenty years' experience in the City and North America. She specialises in the media and

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David Graham



David Graham's career in broadcasting began at the BBC, where as a producer in the Current Affairs department of BBC

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Geoff Metzger



Geoff Metzger worked as a film editor, writer, producer and director of documentary and factual television programmes

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